

**DECENTRALIZATION: FINANCE AND MANAGEMENT PROJECT**

Associates in Rural Development, Inc.

*in collaboration with*

Workshop in Political Theory and Policy Analysis, Indiana University

Maxwell School of Citizenship and Public Affairs, Syracuse University

**Institutional Analysis and the Conduct  
of Policy Reform: Seeking New Rules  
of Economic Organization in Cameroon**

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## FOREWORD

In 1988 Associates in Rural Development, Inc. (ARD), in collaboration with Indiana University's Workshop in Political Theory and Policy Analysis and the Maxwell School of Citizenship and Public Affairs at Syracuse University, began a research and development effort focused on decentralized public service provision. The Decentralization: Finance and Management Project (DFM), sponsored by the U.S. Agency for International Development (USAID), was designed to study problems associated with the failure of many development projects to achieve sustainable impacts--particularly those in rural areas managed by central government agencies. The project's research agenda has analyzed a variety of institutional arrangements and resource mobilization strategies to determine their effects on the sustainable provision of rural roads, irrigation infrastructure, health and education services, and the management of renewable natural resources. Field investigations and desk studies have also analyzed broader decentralization policies and issues relating to local government operations and finance.

In the initial years of the project, a series of state-of-the-art papers were prepared on the principal sectors of inquiry. These reports included a thorough review of the relevant literature and established a framework for field-level analysis. These early studies were the basis for two published books, several journal articles, and numerous conference papers dealing with the problems of rural infrastructure and irrigation management. In addition to these core research products, numerous policy studies, field research initiatives, and project designs and evaluations were conducted at the request of USAID missions in Asia and Africa and the central bureaus of USAID/Washington. These efforts provided project research staff the opportunity to test and refine analytic methods and to demonstrate the utility of institutional analysis to a variety of development problems.

At the conclusion of this major effort covering seven years and 15 different countries, a series of final papers has been prepared that synthesize the cumulative research findings and lessons learned from the project. These include a report summarizing four years of research and analysis on governance and management of irrigation systems in Nepal; a synthesis of several years of research on economic and institutional policy reform in Cameroon; an analysis of DFM research on decentralized public service provision in Africa; a research synthesis on local governance and management of renewable natural resources; a paper on the concept of social capital and its implications for development; and a synthesis of research on rural road maintenance. In addition, the DFM legacy includes two papers providing practical project design guidelines in the areas of rural infrastructure and natural resources and a final report summarizing the project's principal research and development accomplishments.

The DFM project staff from ARD, the Workshop in Political Theory and Policy Analysis, and the Maxwell School extend their sincere appreciation for the sponsorship of this project by USAID. The Agency's research programs aimed at improving our understanding of the development process and thereby the effectiveness of financial and technical assistance

represent a significant contribution to the donor community and its partners in the developing world. We would also like to acknowledge and thank the dozens of colleagues from the academic and development assistance communities as well as the citizens and representatives of host countries who have participated in our enterprise. Our group has learned a great deal from this project, much of which is reflected in this final series of documents. We hope that this learning experience has also benefitted our collaborators in the U.S. and abroad.

## ACKNOWLEDGMENTS

This report draws on the work of the Program of Research on Market Transitions (PROMT) to review and assess the use of institutional analysis and design in the conduct of policy reform in Cameroon. PROMT was sponsored by USAID/Cameroon in order to learn more about the process of policy reform and the tools of analysis most appropriate to its practice. The research was one component of the Program of Reform for the Agricultural Marketing Sector, Phase I (PRAMS I), supported by USAID in cooperation with the Cameroonian government. PROMT was organized and conducted by the Decentralization: Finance and Management (DFM) project, sponsored by USAID's Bureau for Research and Development and managed by Associates in Rural Development (ARD).

PROMT was very much a team effort as reflected in the content of this report, which draws on case studies conducted by members of the team and published in earlier reports. In addition to the research director, the team members were as follows:

- Daniel Green, a political scientist with a Ph.D. from Indiana University, now a member of the faculty at the University of Delaware. Green was posted for a year in Yaounde, Cameroon, where he monitored the process of policy reform.
- Donald Hinman, an agricultural economist with a Ph.D. from Michigan State University, who contributed studies of organizational models of policy reform and the selected portions of the World Bank's policy reform portfolio in Cameroon.
- Tjip Walker, a research fellow with the Workshop in Political Theory and Policy Analysis and Ph.D. candidate in political science at Indiana University, formerly a project coordinator with USAID/Cameroon. Walker contributed case studies of two policy reform programs related to fertilizer privatization in Cameroon, in addition to assisting with general project direction.
- Paul Wessen, a doctoral student in agricultural economics at Michigan State University, who monitored the process of reform within the North West Cooperative Association while residing in the North West Province of Cameroon for one year.

Louis Siegel managed PROMT for ARD/DFM, with assistance from Barbara Messner. Both were a steady source of encouragement throughout the research project. Siegel, Walker, and Wessen provided extensive and helpful comments on an earlier draft of this report. The report also benefitted from earlier work in Cameroon by Susan Wynne and Sheldon Gellar.

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Eleven Peace Corps volunteers in the North West Province contributed to the research effort there. They were Ted Johnson, Shauna Blanchard, Ellen Weinreb, Chris York, Andrew \*Clapham, Mike Carney, David Sablatura, Keith Sandbloom, Robin Towsley, Greg Russell, and Marissa Parente. At the North West Cooperative Association, the assistance of the General Manager, Robert Ghogomu, and his deputy, Paul Ngabir, plus the entire staff, was indispensable.

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## ACRONYMS

AMIS	Arabica market information system
APCC	Arabica Policy Coordinating Committee
ARD	Associates in Rural Development, Inc.
CCCE	Caisse Centrale de Coopération Economique
CDC	Commonwealth Development Corporation
CDSS	Country Development Strategy Statement
CICC	Comité Interprofessionnel du Café et du Cacao
CFRF	Corp Finance Revolving Fund
CIG	Common initiative group
COOP/MUT	Department of Cooperation and Mutuality
DFM	Decentralization: Finance and Management Project
DPA	Department of Agricultural Products
EC	European Community
EDF	European Development Fund
FCFA	<i>Franc Coopération Financière en Afrique Centrale</i>
FSSRP	Fertilizer Subsector Reform Program
GDP	Gross Domestic Product
GRC	Government of the Republic of Cameroon
GTZ	German technical assistance
MINAGRI	Ministry of Agriculture
MINDIC	Ministry of Industrial Development and Commerce



MOU	Memorandum of Understanding
NIMA	New Internal Marketing Arrangements
NPMB	National Produce Marketing Board
NW	North West
NWCA	North West Cooperative Association
ONCC	Office National du Cacao et du Café
PCVs	Peace Corps Volunteers
PIAs	Program Implementation Agreements
PRAMS	Program for Reform of the Agricultural Marketing Sector
PRISERI	Private Sector Research Institution
PROMT	Program of Research on Market Transitions
PSIE	Program Spécial d'Importation d'Engrais
R&D	Research and Development
SAL	Structural Adjustment Loan
SAP	Structural Adjustment Program
SODECAO	Société de Développement de Cacao
SODECOTON	Société de Développement du Coton du Cameroun
SOCAPALM	Société Camerounaise des Palmeraies
TA	Technical Assistance
USAID	U.S. Agency for International Development
UCCAO	Union Centrale des Coopératives Agricoles de l'Ouest

## **I. INSTITUTIONALISM IN CONTEXT: DEVELOPMENT AND POLICY REFORM IN AFRICA**

Development assistance has changed dramatically over the past decade and a half, moving away from a long-standing focus on physical capital and technology transfer to new concerns with public policy and governance. The nature of assistance has been converted from a series of development "projects" designed to augment a country's physical infrastructure to an extended program of policy reform intended to transform the basic rules of economic organization that structure production and exchange. Although the aim of economic growth with equity remains largely the same, the means calculated to achieve the end have been altered, not just marginally but in a fundamental way. The magnitude of the change in orientation suggests the need for considerable retooling in the practice of development assistance. Surely the same analytical tools and assistance modalities that served to design and implement "projects" would not serve equally well to adjust the major features of economic policy and organization in developing countries. In Cameroon, the resident mission of the U.S. Agency for International Development (USAID/Cameroon) cultivated a distinctive approach to policy reform, one that drew on an emerging interdisciplinary orientation in the social sciences called the "new institutionalism." USAID/Cameroon also sponsored a research program, the Program of Research on Market Transitions (PROMT), in order to apply the concepts, theories, and methods of institutionalism to a study of the policy reform process. This report gives an account of these efforts--how institutional analysis was applied to the conduct of policy reform in Cameroon and to what effect--in the transformation of economic organization.

### **A. Policy Reform in Sub-Saharan Africa**

Policy reform in sub-Saharan Africa refers to an array of changes in the ways and means by which some 29 countries and their governments choose to govern or otherwise influence their economies. The changes sought include sharp reductions in government budget deficits; the maintenance of reasonable interest rates; exchange-rate devaluations; trade liberalization; more market-friendly arrangements for exporting agricultural products (and importing inputs such as fertilizer); government disengagement from direct involvement in production and trade and/or the conduct of public enterprise activities under more rigorous conditions of profitability; and more liberal rules for organizing economic activity in general. The purpose has been to place African countries firmly on a path of sustained economic growth, in most cases overcoming decades of stagnation.

Since the mid-1980s, policy reform efforts have been intensive and widespread; the World Bank (1994) reports 29 structural adjustment programs (SAPs) in place between 1987 and 1991 south of the Sahara. Structural adjustment has clearly provided the overarching framework for policy reform activities throughout the sub-Saharan region. The commonalities in policy reform across the region owe a great deal to the pervasive influence of the Bank as well as the International Monetary Fund. Yet, policy reform also reflects a broad consensus

among the members of the international donor community, including the U.S. Agency for International Development (USAID), that patterns of development assistance had to change if African development were to succeed. Instead of continuing to support the direct involvement of African governments with their economies, lenders and donors would condition further assistance on a more disciplined government role in the economy, including a systematic distancing of government from private economic activity. This would, it was hoped, allow competitive market forces to drive the economic development process and lead to rapid economic growth.

The results thus far, as reported by the World Bank (1994), have been mixed and, overall, disappointing. Macroeconomic policy saw perhaps the greatest improvement, followed by market liberalization, and, more distantly, public enterprise reform. Exchange rates, while better, need further adjustment (World Bank 1994: 56). Budget deficits have come down but remain too high (World Bank 1994: 45-48). Progress in liberalizing the marketing of export crops has also been slow. While most sub-Saharan governments have attempted some degree of marketing reform, few have abolished marketing boards, and most retain some sort of government control or influence over producer prices while making efforts to link them to world prices (World Bank 1994: 81-83). Demonopolization of export crops, allowing some degree of competition, has occurred in 11 out of 27 countries (World Bank 1994: 95). Public enterprise reform has progressed the least of all, with "no significant reduction in the number of enterprises" and "little improvement in their financial performance" (World Bank 1994: 103). While the World Bank remains convinced that structural adjustment is the correct route to economic growth, its experience with policy reform so far has been sobering.

## **B. USAID/Cameroon and an Institutional Approach to Reform**

Cameroon, a Franc-zone country with a divided colonial history (majority-Francophone, minority-Anglophone), was a comparative success in the African context prior to 1986, when it was suddenly plunged into an economic crisis that still persists. Between 1977 (when petroleum production came on-line in Cameroon) and 1985, Cameroon enjoyed rapid rates of economic growth. For the first half of the 1980s, the gross domestic product grew at an average annual rate of 8.1 percent. Most of the growth, however, was due to oil revenues. A sharp reduction in world oil prices in 1986 decreased revenues from 722 billion FCFA to 233 billion FCFA over the next two years. The oil shock was followed in the same year by similar reductions in the world prices of coffee and cocoa, Cameroon's two leading agricultural exports. Coffee revenues declined from 110.2 billion FCFA in 1984-85 to 61.2 billion FCFA in 1987-88. By 1989 the Cameroonian government (GRC) was deeply in debt, both to foreign creditors and to its domestic agricultural producers.

Unlike the GRC, however, USAID viewed the sharp economic reversal of 1986 as more than a simple change of fortune creating a need for assistance. The strong macroeconomic indicators witnessed over the previous decade were now seen as having concealed basic structural and institutional weaknesses, manifest primarily in an overextended and inefficient public sector (USAID 1989a: 1). For many people in the donor community including USAID, not to mention numerous Cameroonians, the sudden economic misfortune was a golden opportunity to obtain badly needed reforms. The quid pro quo for obtaining financial support from the world community was to be a commitment to structural adjustment and policy reform. When, once again, cyclical world markets would smile on Cameroon, policy reforms would be in place to channel the increased revenues into broad-based economic growth rather than the renewed expansion of an inefficient and corrupt state apparatus. These considerations led USAID to negotiate the first policy reform agreement in Cameroon--the Fertilizer Subsector Reform Program (FSSRP), adopted in 1987.

In 1989, a general framework for policy reform was established by Cameroon's first Structural Adjustment Loan (SAL-I). The SAL was organized into reform sectors intended to cover virtually all arenas of economic activity. Included were commitments to reduce the government's fiscal deficit by increasing revenues and decreasing expenditures, in particular by reducing the government's wage bill; industrial and commercial sector reforms that would lower barriers to imports and exports, decontrol domestic prices, and redesign both labor and investment codes of law; rural sector reforms that would liberalize the internal and external marketing of key agricultural exports, displacing direct government participation in these sectors, and that would allow farmers' cooperatives to operate free of government interference; and public enterprise reforms that would either liquidate, privatize (divest), or rehabilitate a range of parastatal organizations, including many directly involved in the production, processing, and marketing of agricultural commodities. However, the details of reform would be worked out in subsequent discussions with the World Bank or in more narrowly focused policy-reform programs sponsored by bilateral donors.

USAID/Cameroon brought to the matrix of reform activity its own distinctive approach to policy reform: one based on institutional analysis and design. This approach would be used to devise and carry out a reform strategy focused on two commodities--fertilizer and arabica coffee--plus the redesign of the national law on cooperatives. The Mission's institutionalist orientation plus the strong institutional implications of arabica marketing reform combined to create a unique experience with reform, one worthy of systematic study and analysis. USAID/Cameroon itself recognized the potential research value in what it was doing and therefore conducted its reform program in tandem with an applied research program, which produced the case materials that form the basis for this report.

In its *Country Development Strategy Statement* (CDSS) adopted for the period FY 1990 to FY 1994 (USAID/Cameroon 1989a), the Mission embraced an institutionalist perspective on policy reform and declared its intention to use institutional analysis in both the design and implementation of its policy reform programs. For the Mission, an institutional

approach was distinguished by its focus on rules and rule-based incentives for both economic and political actors. Citing the "new institutionalists" in general and Hernando de Soto (1989) in particular, USAID/Cameroon embarked on a determined effort to incorporate an institutionalist orientation into its analysis and programming. In order to carry out this commitment, the Mission would draw extensively on services provided by the Decentralization: Finance and Management project (DFM), a USAID Research and Development (R&D) project that specialized in applied institutional analysis.

Institutionalism is clearly one of the notable trends to emerge in social science over the past two decades. Following the lead of economists such as Oliver Williamson (1985) and Douglas North (1990), sociologists such as James Coleman (1990), and political scientists such as Vincent Ostrom (1989, 1991) and Elinor Ostrom (1990, 1992), the "new institutionalists" have increasingly tackled issues related to development. As applied to economic policy reform, institutional analysis<sup>1</sup> is based on two key ideas:

- Goods and services are different, often in subtle ways, and therefore require different institutional arrangements for their effective provision, production, exchange, and use. Included are shades of difference among the vast array of private goods considered appropriate for some sort of market-based provision.
- Alternative institutional arrangements can create very different individual incentives, greatly affecting the capacity of individuals to interact in productive ways that are conducive to economic growth. Included are alternative institutional arrangements within the private sector and in the nexus of private and public sectors.

The institutionalist orientation leads to a corresponding pair of research hypotheses and companion principles for the conduct of policy reform:

- Hypothesis One: The problems encountered in policy reform vary with the characteristics of the goods and services involved in emerging market relationships. The normative implication is that policy reforms should be designed in ways that complement the characteristics of particular goods and services.
- Hypothesis Two: The problems encountered in policy reform vary with the institutional arrangements available in a given country for translating intentions into actions and outcomes. The normative implication is that the design and implementation of policy reform programs, including the role of donors, should complement existing institutional capabilities, which consist not primarily in

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<sup>1</sup>The Appendix to this report briefly summarizes a framework for institutional analysis as used by DFM in Cameroon.

the technical capacity of organizations to carry out their tasks but in the compatibility between the incentives inherent in existing institutional arrangements and the objectives of reform. In other words, policy reform programs have to be able to supply what is missing in existing institutions.

These considerations apply both to the design of a reform--the new configuration of rules that is to be put in place--and to the design of a reform program--the transitional effort needed to establish new rules. A reform should both fit the nature of the goods and services involved and create incentives consistent with reform objectives. A reform program should be congruent with the reform it seeks to establish--congruent in terms of both the characteristics of goods and services and incentives--as well as complementary to existing institutional capabilities needed to undertake and sustain the intended reform.

USAID/Cameroon recognized that conducting policy reform according to institutionalist principles and using institutionalist methods amount to a tall order. The CDSS (USAID/Cameroon 1989a: 16) argued that "adopting an institutional perspective ought to sober reformers," but went on to say that "it should not be defeating." Through its institutionalist lens USAID/Cameroon saw policy reform as difficult but feasible if done right. When the Mission set out to do policy reform in a systematic and sustainable way, it found itself engaged in a pioneering effort to apply institutional analysis and design to the conduct of development assistance in the field. For this reason alone, their work merits close examination.

### **C. Policy Reform and Applied Research in Tandem**

USAID/Cameroon's first policy reform initiative was the Fertilizer Sub-Sector Reform Program (FSSRP), adopted in 1987 and made operational the following year. FSSRP sought to replace a government-controlled fertilizer procurement and distribution system with a free-market arrangement. At the same time, fertilizer subsidies would be phased out. The hallmark of the FSSRP was a transitional privatization structure that encouraged entrepreneurship by providing low-interest credit through commercial banks, which also controlled access to the public subsidy fund. USAID also took on an informal trouble-shooting role in the governance of the transitional program, in addition to helping entrepreneurs, who were entering the market for the first time, make their way through a maze of bureaucratic constraints that remained in place, crosscutting a wide range of commodity subsectors. Together with a companion fertilizer reform program--the *Programme Spécial d'Importation d'Engrais* (PSIE) supported by the European Community (EC)--the FSSRP represented Cameroon's entry into donor-supported policy reform activity, preceding the adoption of SAL-I by a full two years.

By mid-1990 USAID, drawing heavily on its experience with fertilizer reform in Cameroon, had launched the Program for Reform of the Agricultural Marketing Sector, Phase I (PRAMS I), a 4-year program aimed at liberalizing and privatizing the internal and external marketing of arabica coffee. PRAMS I included a research component that would examine the process of policy reform in Cameroon--including the efforts of various donors-- through the Mission's newly acquired institutionalist lens. The program committed the GRC to policy reforms intended to introduce private and competitive arrangements for the marketing of arabica coffee, both internally in the purchase of parchment coffee from farmers and externally in the sale of green coffee on the world market. The existing arrangements were either government-dominated and regulated, as in the case of internal marketing, or directly supplied by a government marketing board, as in the case of external marketing. Specifically, PRAMS I provided for the extension of export rights to private businesses and cooperatives (and government withdrawal from the export business), the elimination of monopsonist buying privileges on the part of cooperatives, and the decontrol of producer prices decreed annually by the government. These reforms would lay the institutional foundation for the operation of the arabica subsector by private firms and/or farmer-controlled cooperatives engaged in competition with one another and directly exposed to the discipline of the world market.

In addition to the policy reform component, PRAMS I included a cooperative restructuring component intended to facilitate the entry of cooperatives without prior market experience into a competitive environment. Focused almost entirely on the North West Cooperative Association (NWCA) in the North West (NW) Province, this component sought to maintain the existing institutional infrastructure while adapting it to the more liberal policy regime being created. While the policy-reform component was concerned with market-level rules, the cooperative restructuring component attended to the vertical links between stages of production in the arabica industry.

Lastly, PRAMS I included a research component, the Program of Research on Market Transitions (PROMT), intended to monitor the reform process in both PRAMS I and FSSRP, including the related reform of the national cooperative law, comparing these experiences to policy reform efforts carried out by other donors, including the EC's fertilizer program, PSIE, and selected public enterprise reform programs supported by the World Bank. Methodologically, PROMT used a comparative perspective, studying similar programs undertaken by different donors in a single country. The research design thus held constant the general institutional context across the cases studied while varying both the economic goods involved and the approaches to policy reform being followed by different donors.

As an applied research program, PROMT's purpose was two-fold: (1) to supply USAID/Cameroon with timely information and analysis related to its policy reform portfolio and (2) to contribute to a more systematic understanding of policy reform as a basis for the design of more effective modalities of assistance by USAID and other donors. For this purpose PROMT fielded a research team composed of two full-time researchers in Cameroon,

one agricultural economist and one political scientist, two part-time researchers reflecting the same two academic disciplines, and a research director who provided technical guidance and supervision to the team and who visited Cameroon on an intermittent basis during the project.

#### **D. Research Questions and Programmatic Issues**

If the policy reform agenda outlined by international lenders and donors and accepted in principle by many African governments is to be effectively pursued, there is much to be learned about how to conduct reform and how development assistance can be programmed to serve these ends. PROMT was guided by a set of research questions suggested on the one hand by institutionalist theory and on the other hand by USAID/Cameroon's experience in the conduct of policy reform. These are at once the practical questions that the Mission faced as it struggled to understand the potentials and puzzles surrounding reform and the theoretical questions that should guide its study.

*What is the nature of policy reform? What sort of process is involved? What is the most effective role for donors in the process?*

Relatively little is known in a systematic way about the nature and process of policy reform in sub-Saharan Africa. As a development assistance modality, policy reform is only a little more than a decade old. It should not be surprising that a policy innovation of nearly continental proportions is subject to trial and error. The disappointing results experienced so far have, nevertheless, caused many observers to question the feasibility of reform and (less frequently) its desirability as well. On the nature of the policy reform process hang a number of important issues about how to conduct reform--appropriate modes of analysis, assistance modalities, and the role of donors, always a matter of dispute. Most efforts at African economic liberalization have been conducted through negotiations between international lenders/donors and host countries. The immediate political incentives favorable to reform therefore depend on external forces. To what extent are domestic economic policies and institutions tractable to international agreement? The answer may depend on the role that donors choose to play in the process.

The appropriate donor role depends on the nature of the process, including characteristics that may be variable with different types of change. Tjip Walker proposed the terms "catalytic" and "mediated" to characterize the alternative approaches adopted by donors (see Oakerson and Walker forthcoming). Most donors assume a catalytic role--they help get reform started, obtaining the host country's commitment to a new, agreed-upon policy direction, while leaving implementation largely to the government. Alternatively, donors can adopt a mediating role, facilitating a series of transitional steps. Rather than a process that can be programmed to unfold routinely once it gets underway, reform is seen as an extended process, problematic at each step. In this view, one false step can lead to a different path, diverting efforts away from reform objectives. Because USAID/Cameroon saw reform as



extended process, the Mission developed policy-reform programs that would assist with mediation along the entire path of reform, not just at the beginning.

*How does the process of market transition work?*

Much of policy reform has been directed at strengthening market dynamics by shifting economic activity from the public to the private sector. This implies a process of transition, from non-market to market organization. In this process, are markets "unleashed," or "crafted" by design? Both classical and neoclassical economics assume that markets *operate* according to an "invisible hand," that is, markets do not require (and are in fact distorted by) central coordination. Are markets *created* in the same fashion as they operate? Is there a difference between market formation and market operation? The World Bank (1994) refers to policy reform as "unleashing markets," implying that markets are spontaneously formed, without coordination, by independent economic actors, in the same way that they operate. Or does market formation require intentional design and conscious coordination, a process of institutional "crafting" (Walker 1994b) that does not characterize market operation?

*What is the relationship between commodity-subsector reforms and crosscutting reforms that affect a whole economy?*

Policy reform can be focused in two ways. *Subsectoral reforms* focus on restructuring "vertical slices" of an economy, each slice encompassing the stages of production and marketing for a single commodity or service. Each vertical slice defines an "industry" that embraces all of the economic activities associated with the production and exchange of the particular commodity or service. *Crosscutting reforms* focus on removing or modifying constraints that cut horizontally across a range of subsectors, either by affecting a single stage of production or marketing or by affecting a single factor of production (e.g., customs reform, investment reform, or labor reform). How does one choose between and/or combine these two types of reform in a policy reform portfolio? Is the choice one between two broad approaches viewed as competing alternatives, or are the two types of reform better viewed as complements to be mixed and matched in some proportion? If complements, how closely do subsectoral and crosscutting reforms need to be coordinated?

*What is the relationship between economic reform and governance?*

Economic reform depends on changing the rules that affect the conduct and performance of economic actors. The question is--what does it take to change operating rules in the African context? Do sustainable changes in economic rules depend on deeper changes in the structure and process of governance? The World Bank (1994) is now suggesting that "good governance" is prerequisite to effective economic reform. Just as the quest for economic growth led eventually to economic policy reform, does the quest for better governance imply a need for political reform? Would such political reform, as often suggested, have a democratic character?

To each of these questions institutionalism suggests hypothetical answers consistent with the experience of policy reform in Cameroon but applicable more broadly. The remainder of this report explores those questions and answers, applying the theory and methodology of institutional analysis to the comparative case study materials of PROMT. Among the cases studied by PROMT, this report focuses on the policy reform experiences directly connected with PRAMS I, drawing on the other cases for comparative purposes. Chapter II takes up the experience of reform in the NW Province, that is, the redesign of the cooperative structure for marketing arabica coffee. Chapter III explores the paths of policy reform related to PRAMS I, including both changes in the national marketing rules governing arabica coffee and changes in the national cooperative law. Chapter IV compares the experiences of PRAMS I with those in fertilizer reform and selected World Bank efforts, especially public enterprise reform.

## **II. A CASE OF INSTITUTIONAL DESIGN: NEW COFFEE MARKETING ARRANGEMENTS FOR THE NORTH WEST PROVINCE**

PRAMS I was a reform program that proceeded on several fronts simultaneously. First and foremost, it was an effort to introduce new, market-friendly rules into the arabica coffee subsector. The old rules largely proscribed competition by enforcing monopsony buying arrangements from the smallest farmers' cooperative to the National Produce Marketing Board (NPMB), which marketed coffee and cocoa externally. With the advent of reform, all former monopsonists--cooperatives and the NPMB--would eventually lose their exclusive buying privileges (and obligations). In addition, the old rules empowered the government to fix a uniform producer price for coffee on a national basis, which it did annually, as well as to determine the "margins" that would be paid to cooperatives, including cooperative unions and federations, as reimbursement for the costs incurred in collecting, transporting, and processing coffee. PRAMS I sought to change all that, freeing cooperatives from control (and potential subsidy) by the government and allowing producer prices to vary among competing buyers. In order to secure the full measure of freedom for cooperatives needed to operate effectively in the marketplace, PRAMS I also supported reform of the national cooperative law, although this effort was viewed as somewhat contextual to the principal focus of the program on marketing reform. Secondly, PRAMS I included a component of assistance to the North West Cooperative Association (NWCA), the federation of 11 cooperative unions and 40 cooperative produce marketing societies formerly responsible for collecting and processing arabica coffee in the North West (NW) Province as an agent of NPMB.

The rationale for, design of, and conduct of the "cooperative restructuring" component, as it was called, emanated from the institutionalist approach being pursued by the Mission; they are the subject of this section. The reform process introduced a new and fundamentally different institutional design for marketing coffee through NWCA. The case study therefore provides an effective illustration of institutional analysis and design in practice. From the experience we learn something of both the potential of an institutionalist approach and its possible pitfalls.

### **A. The Rationale for Assisting NWCA**

Concern for the network of coffee cooperatives in the NW Province lay close to the root of PRAMS I. If not its entire justification, it was at the least a major motivation for the USAID Mission's choice of the arabica subsector as a policy reform venue. The World Bank and the GRC had agreed under the terms of the First Structural Adjustment Loan (SAL-I) to Cameroon in 1989 that the marketing of arabica coffee in the NW Province would be rapidly liberalized, initially by allowing private traders to enter and compete with the existing cooperatives and soon thereafter by allowing both private traders and cooperatives to compete with the marketing board in the export of coffee (World Bank 1989b: 21). The broad purpose

was to increase the competitiveness of Cameroon's exports by improving both internal and external marketing, with the NW Province serving as a testing ground for the rest of the country. The World Bank (1989b: 21) explicitly saw the NW cooperatives as "inefficient" and competition as the appropriate remedy. USAID, however, saw the situation somewhat differently. Concerned about the immediate survival of the virtually bankrupt cooperative structure, the Mission argued that NWCA deserved "a fair chance to demonstrate its ability to function in a liberalized and competitive environment. To do otherwise would negate 35 years of cooperative development in the region and raise the social costs of adjustment unnecessarily" (USAID 1989b), perhaps threatening other policy reform initiatives.<sup>2</sup>

Much of the concern for giving NWCA "a fair chance" stemmed from the fact that the other major group of arabica marketing cooperatives, the *Union Centrale des Coopératives Agricoles de l'Ouest* (UCCAO) located in West Province, had been free since 1958 to conduct its own arabica exports. This arrangement was essentially a political payoff to the West Province, the scene of an armed revolt by members of the entrepreneurial Bamileke tribal group in the late 1950s (Gellar, Oakerson, and Wynne 1990: 51). During the period of high coffee prices on the world market, UCCAO accumulated significant reserves from its arabica sales. As a result, UCCAO would have been able to operate in a newly liberalized marketing environment at a competitive advantage over NWCA. By contrast, NWCA's farmers were owed payments in arrears by the marketing board, a fact that undermined the credibility of the government-dependent cooperative structure as well. Therefore, USAID believed that a different approach to liberalization was needed, one that would soften the initial blow to NWCA and create an opportunity for the cooperatives to ready themselves for the new world of market competition.

USAID was no less committed than the World Bank to the creation of a free-market regime in the arabica subsector and other agricultural commodity subsectors as well--after, that is, a period of transition in the NW. While SAL-I called for the introduction of private traders to the NW Province in 1989-90 marketing season, USAID sought and obtained a delay of this move at least until the 1991-92 season, two years later, and, subject to review, until 1992-93. In other ways, however, USAID went farther than the Bank in its approach to reform in the arabica subsector. The World Bank (1989a: 43) sought to create a "flexible pricing system" that could respond to world market prices, but not necessarily a fully liberalized pricing system. The partially liberalized arrangement would include government-set producer pricing floors for coffee, cocoa, and cotton and continued reliance on a stabilization fund that would receive a portion of the "excess" revenue from the sale of these crops. PRAMS I, by contrast, sought and obtained full price liberalization for arabica, with no government role in producer pricing, and the elimination of the stabilization fund in the arabica subsector. The robusta coffee and cocoa subsectors were restructured--with assistance from the French government--more along the lines envisioned by the World Bank. USAID

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<sup>2</sup>For example, the demise of cooperatives would disrupt the distribution of fertilizer until new marketing arrangements could be devised. This was of direct concern to USAID in its conduct of fertilizer reform through the FSSRP.

nevertheless contemplated the extension of its arabica reforms to robusta and cocoa in a PRAMS II that, as it turned out, would not come to pass.<sup>3</sup>

USAID also argued, convincingly, that arabica offered a better opportunity to pursue reform than either robusta or cocoa (USAID/Cameroon 1989c: 9). The arabica market appeared to offer better growth potential, especially if the quality of Cameroon's arabica could be improved. The arabica subsector thus seemed to afford the best prospect among Cameroon's various export crops for market liberalization that would generate an economic payoff. Within the subsector, it was the NW cooperative structure, entirely new to export marketing, that would possibly be in need of transitional assistance. Whether such assistance was actually warranted and the type of assistance that would be appropriate were both matters still to be determined in 1989 once the Mission had tentatively settled on an arabica-subsector focus.

## **B. Solving an Institutional Puzzle**

Initially, USAID did not contemplate direct participation in the delivery of assistance to NWCA. Instead, the Mission became involved in discussions between NWCA and the Commonwealth Development Corporation (CDC), a commercially oriented foreign- assistance agency of the British government with extensive experience in agricultural exports, including coffee. The discussions were aimed at setting up a joint venture company to export arabica on behalf of the NWCA. This arrangement, it was thought, would supply NWCA with the technical assistance and financial backing needed to enter effectively into a competitive, market-disciplined environment. USAID's role was envisioned as one limited to policy reform activities vis-a-vis the government, while NWCA would be strongly linked to the global economy, not just in terms of the export market, but in terms of financial and technical organization as well. Both USAID and NWCA would eventually, however, back away from this view of the future and proceed without the CDC's participation.

The sticking point was CDC's insistence on adopting a top-down management approach to the operation of the cooperative enterprise. This was the only way that CDC would commit its resources to assist NWCA. Without a hierarchical management structure, CDC argued that it could not be assured of a return on its financial investment (or even that it could recover its money once loaned to NWCA).<sup>4</sup> By creating a separate joint-venture company to be managed by CDC and to which NWCA would be contractually obligated to sell its produce, CDC would have effective control over the operational side of the

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<sup>3</sup>The Mission also foresaw a PRAMS III that would liberalize the marketing of chemical inputs to agricultural production, such as pesticides, following on the FSSRP. This too would never get beyond the concept stage.

<sup>4</sup>Bates (1989) indicates that the need to obtain venture capital in Kenya often led to capitalist structures that feature a high degree of vertical integration.

cooperative enterprise, with its own personnel filling key positions in the new company alongside NWCA employees. After enduring some 30 years as a "slave of the marketing board,"<sup>5</sup> NWCA was disinclined to enter into such an arrangement, even as a transitional measure. Moreover, CDC was offering low-interest loans while USAID was prepared to offer free project assistance through a grant to the Cameroonian government.

USAID was concerned from the outset that the restructured cooperative enterprise be responsive and accountable to farmers, who were considered the principal beneficiaries of the project. Farmers had to be able to use their cooperatives to protect and advance their economic interests. This implied a decentralized, bottom-up approach to the governance of the cooperative structure. How this concern could be reconciled with CDC's interest in managerial control became a contentious issue between USAID and CDC as the discussions continued. By July 1990, USAID had decided that it should directly manage its own program of assistance to NWCA.

For research and advice on how to proceed in assisting NWCA and restructuring the cooperative enterprise, as well as reforming the arabica subsector more generally, USAID turned to DFM and a team of institutionalists. Much of the research focused on the institutional status quo in West and North West Provinces, plus an analysis of the "nature of the good"--arabica coffee. High operating costs and low coffee quality were found to be the two major obstacles to development of the arabica subsector and enhancement of farmer income. On the basis of this work the team proposed an institutional design that would restructure the relationships among the NW cooperatives (Gellar, Oakerson, and Wynne 1990) to promote the twin objectives of cost reduction and quality improvement. The design, which became the basis for the cooperative restructuring component of PRAMS I, featured the introduction of market-like relationships among the cooperative organizations within NWCA.

### *1. Nature of the Good*

Institutional analysis begins by considering the physical and technical nature of the "good" being provided, produced, marketed, or used, as the case may be. Goods and services can be sorted in broad terms into four major categories: public goods, private goods, common-pool goods, and toll goods (V. Ostrom and E. Ostrom 1991). Coffee is a private good, exhibiting both exclusion (once coffee is produced, individual consumers can be easily excluded) and subtractability (one person's consumption displaces consumption by others). As a private good, coffee can readily be produced and exchanged in the marketplace. However, arabica coffee exhibits subtly different characteristics as it is transformed from ripe cherries hanging on the tree, to parchment coffee that has been pulped, washed, fermented, and dried, to green coffee that has been hulled and graded, to roasted coffee beans, to ground coffee, to coffee in the cup. Marketing arrangements also exhibit variation as coffee moves

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<sup>5</sup>The characterization is one used by a member of the NWCA board of directors during a periodic review of PRAMS I.

through these stages of production. Even if organized within an overall free-market framework, the structure of the coffee industry varies with each link in the production chain. At issue in Cameroon was the type of organization that would intervene between coffee on the tree and green coffee ready to export.

Arabica coffee also is different in important ways from its close cousin, robusta coffee, also grown in Cameroon. Coffee marketing is exceptionally sensitive to quality, and the major world buyers invest substantially in quality-testing. Arabica is prized for its superior, mild flavor, but it also is distinguished by quality control problems not present in the production of robusta. The main differences are in harvesting and initial processing. Arabica is harvested when the coffee cherry has just ripened, while robusta is allowed to hang on the tree until the cherry is dry. For arabica, timing the harvest is crucial, and harvesting should extend over a period of time as the cherries ripen. Within 48 hours of harvest, arabica must be pulped, washed (in clean water), and dried, leaving the beans encased in a thin parchment skin. This process, which includes a period of fermentation, is critical to arabica quality. Unwashed arabica is no better than robusta. Overly fermented beans are worse, producing undesirable flavor in the cup. Harvesting and processing are labor intensive operations that, in order to maintain quality, require personal skill and care.

Both robusta and arabica are hulled--robusta to remove the dried pulp and arabica to remove the parchment. This can be done mechanically in mills, where the coffee is also graded for size and shape, sorted to remove bad beans, and bagged for shipment. Except for sorting, which is usually done by hand in Cameroon, hulling and grading exhibit economies of scale. International marketing also requires scale, as buyers typically deal in fairly large quantities. As coffee moves through the chain of production it is progressively aggregated in order to realize greater and greater economies of scale.

Quality improvement must focus mainly on the harvesting and initial processing of arabica--the production of parchment coffee. In both the West and NW Provinces this production process is carried out by smallholders, independent farmers who grow a few hectares of coffee, numbering an estimated 35,000 in the NW. Initial processing is done on the farm using family labor. The farmer then sells the parchment. Pre-reform, the sole legal buyer was the local cooperative, although an active parallel market existed in many areas as large farmers or traders bought parchment for cash and resold it to the cooperative at a profit. Assuming the continuation of smallholder parchment production (barring a shift to estate farming),<sup>6</sup> the development of the arabica subsector hinges on supplying a large number of smallholders with both the information and incentives needed to improve and maintain quality. How to do this became a key institutional issue in restructuring the cooperative enterprise.

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<sup>6</sup>There is no reason to believe that estate farming would necessarily be more effective in controlling quality, given the level of personal skill and care required. With the correct incentives, smallholders can effectively compete with paid laborers or contract producers.

If farmers were to benefit from the economies of scale to be derived from hulling and international marketing, it would also be necessary to control the costs for these operations. Otherwise, the market residual from international sales would shrink and producer prices would suffer accordingly. Lower producer prices dampen farmer incentives to produce and restrict development of the subsector, hurting the entire industry (not just farmers) in the long run. How to obtain economies of scale while controlling costs became another key design issue.

## **2. *Institutional Arrangements***

The choice of institutions is frequently represented as a choice among grand alternatives, for example, markets and states. From this perspective PRAMS I, like most policy reform in sub-Saharan Africa, is a move away from state organization toward markets. Much more is involved in institutional design, however, than the choice of one "ideal type" or standard-form institution over another. Institutions use rules to allocate decision-making capabilities and limitations, specifying "who decides what in relation to whom." Institutional arrangements are open to extensive and often subtle, intricate variation. Fitting institutions to the nature of the good while creating appropriate incentives that can elicit intended patterns of behavior is the multidimensional task of institutional design.

Marketing cooperatives, for example, are neither market nor state, but they must always function in relation to one or the other or both. The policy reform in PRAMS I promised to transform the context of cooperative organization; would it also necessitate major changes in cooperatives? A cooperative structure designed to serve as an agent of the state may be poorly organized for participation in free and competitive markets. Perhaps the type of marketing cooperative that a global financial agency might devise to protect its interests would not serve equally well to advance the interests of local farmers. As USAID considered the possibility of working with NWCA, there were a number of institutional issues to be raised:

- Who determines producer prices, both the initial price paid to farmers (if a two-payment system is used) and the distribution of a residual?
- Who makes sales decisions?
- How are costs allocated among cooperatives at different levels of the structure?
- Who specifies and who enforces quality standards?

In response to such questions, numerous institutional designs are possible--all under the rubric of cooperative organization. NWCA is a cooperative federation, a three-tier structure composed (at the outset of PRAMS I) of 40 marketing societies grouped into 11 cooperative unions, which in turn form the NWCA. Decision-making discretion can be distributed in



various ways among the three tiers, with quite different implications. Failure to address these issues would consign reform to the path of least resistance, one dominated by established interests.

An institutional design must consider the marketing functions that need to be performed in order to link each stage of production to the next. Physically, coffee passes from farmers to acceptance points where it is weighed, valued, and bagged; to coffee mills where it is hulled and graded; to warehouses from which it is transported to seaport and shipped. Within the cooperative structure, two economic transactions occur: (1) when farmers deliver coffee to their marketing societies and (2) when NWCA sells coffee on the world market.

The cooperative structure vertically integrates acceptance, milling, and export marketing, but this is not the only possible market structure. Alternatively, each link in the production chain could be organized as a separate market transaction. Farmers could sell to traders, who sell to millers, who sell to exporters. This arrangement would be based on a "spot market" for parchment coffee, a series of discrete transactions between individual farmers and independent traders. A spot market might also support a less differentiated structure in which exporters or millers employ buying agents who deal with farmers. A second alternative is "contract farming," in which a privately owned coffee mill (either independently owned or owned by an exporter) signs contracts with neighboring farmers to buy their parchment.

Given a cooperative structure, the key points of discretion lie at the two points of market interface--coffee acceptance (buying parchment from farmers) and coffee sales (selling green coffee to international buyers). The transfers of coffee from marketing society to union and from union to the federation are internal transactions within the cooperative structure. One of the key institutional questions is *who "owns" the coffee* as it moves through the cooperative structure. One possible answer is NWCA--the federation. In this case, unions and their member societies act as agents of NWCA. If unions "own" the coffee, both societies and the federation act as their agents in different capacities. If societies "own" the coffee, unions and the federation act as agents. The character of the cooperative institution depends in a fundamental way on how the principal-agent question is resolved. "Ownership," however, is a multifaceted concept--a bundle of rights. It includes the right to buy, hold exclusively, encumber, and sell a commodity, as well as claim the residual from a sale (and incur the obligation for a loss). Within a cooperative structure the rights of ownership can be distributed among different levels of organization.

The basic design problem, assuming a 3-tier structure, is how to distribute marketing authority among the tiers so as to (1) improve and sustain quality while (2) controlling costs--both to the end of enhancing farmers' incomes. Recall that quality depends critically on farm-level operations; the point of discretion closest to the farm-level is parchment acceptance, a marketing function carried out by primary societies. The decision to accept a farmer's parchment and assign a value to it is made at this level. This is the level in the

cooperative structure most likely to be able to influence or control farm-level operations. If societies could be made residual claimants in the sale of their own coffee on the world market, a strong incentive would be created at this level to monitor and control quality. Thus an argument can be advanced for vesting this important aspect of ownership in primary societies.

The right to sell is quite different. One of the principal advantages, potentially, of a cooperative structure that aggregates large amounts of coffee is the ability as a reasonably large seller to attract the interest of world buyers. Marketing flexibility is required to get the best price, arguing for an assignment of sales discretion to the federation. Similarly, there may be some advantage from unions or the federation negotiating with lenders for crop financing to pay farmers at or near the date of delivery; thus the right to encumber the crop can be distributed still differently.

The right to buy--and to determine the initial producer price--is closely linked to incentives for cost control. If the federation determines a uniform producer price for the entire cooperative structure, just as the government previously did for the entire subsector, then farmers will receive the same price for their coffee regardless of the costs incurred by their own primary society and union. The burden of cost control would then fall on the federation, necessitating a top-down management approach by NWCA. Farmers will have less incentive to control costs within their own society and, by extension, within their own union, if the producer price is largely unaffected by their efforts. By contrast, if each primary society determines its own producer price, farmers have greater incentives to demand cost control. As the costs of their own society and union increase, their own producer price declines. This arrangement would create a potentially strong demand at the base of the cooperative structure for cost control. Moreover, it would obviate the need for strong top-down management.

USAID was concerned about the possibility of the NWCA board of directors becoming a marketing board in miniature, insulated from farmer control by layers of authority, accumulating personal profits in the form of various economic rents--the perquisites of position and traditional payoffs associated with patrimonial politics (e.g., jobs and contracts for their clients). Centralized authority creates incentives to allow operating costs to increase, rather than using a hierarchical management structure to keep costs under control. The implication is that central management control by a cooperative federation is not an incentive compatible arrangement. Instead of creating incentives to control costs from the top, as needed, the arrangement creates incentives to allow costs to increase in order to generate rents for those who exercise discretion at this level. The incentives are reiterated at each level in the structure, compounding the problem to the detriment of farmers.

The argument for the decentralization of producer pricing authority is thus strengthened. In order to do this, however, it would be necessary to invent a way to assign all operating costs ultimately to each primary society, so that producer prices will reflect the full internal costs of the cooperative structure. This was handled by creating "internal

marketing arrangements" (USAID/Cameroon 1990) to organize the internal transactions between societies and unions and between unions and the NWCA. Each union would become a producer of services for societies at cost, and the federation, a producer of services for unions at cost. At the start of each marketing season societies contract with their union (and the unions contract with the federation) to deliver an estimated amount of coffee for processing or marketing and pay the union (or federation) a fixed amount per kilogram of coffee for services rendered. Producer prices can be calculated by subtracting the sum of all internal costs, now assigned to each society, from an estimated world market price supplied by the federation. At the end of the season, each society claims the residual left after internal costs are paid and makes a second payment to farmers.

The remaining design problem is to tie the internal marketing arrangements to quality control. The original design paper (Gellar, Oakerson, and Wynne 1990) proposed to track coffee from each society to the point of sale on the world market. In this way societies, as residual claimants, would be rewarded or penalized for the quality of their coffee as reflected in the price it fetched. However, further study showed society-level tracking not to be economically feasible, prohibitively increasing costs at union mills by requiring that each society's parchment be processed separately. The design was modified to track coffee instead from each union. This created a problem, however, in organizing the transaction between societies and their union. Unions would now be required to make a quality judgment in order to reward societies for better quality instead of relying on the world market to make that judgment for them. This modification weakens the design by creating a point of discretion that is subject to potential error and abuse.

The national-level policy reforms also supplied integral components of the institutional design. The loss of monopsony privileges would expose the cooperative structure to potential competition at all levels. Within the structure, farmers would be free for the first time to associate with any society of their choosing (within technical limits imposed by distance), as well as to opt out of the cooperative and sell to traders on the spot market. Exporters would be free to experiment with contract farming arrangements. Reform of the national cooperative law would place the formation of societies and unions within the structure entirely in the hands of farmers. This would allow societies to affiliate with a union of their choosing (again within technical limits). The structure of the whole cooperative enterprise--the number of societies and unions and their relationships--would be determined from the bottom-up, as farmers and representatives seek out the most advantageous arrangements.

The end result was a quasi-market design for organizing the cooperative structure. Each cooperative would be a self-governing and self-supporting organization, free to succeed or fail on its own. Individual farmers would be able to exit from any one cooperative, form new cooperatives, or choose to operate outside the structure entirely. Producer prices would be variable among the cooperatives, allowing farmers to realize the benefit from efficiency gains in any one organization and, potentially, to compare the performance of their own cooperative with others. At the same time, the cooperatives would continue to be associated

collectively in ways that would allow them to capture economies of scale in hulling and export marketing, while linking individual farmers vertically to the world market.

All institutional arrangements face threats that cannot be completely overcome by design. Unless each threat is effectively countered, the design can be expected to fail. The greatest threat to the quasi-market design for NWCA is the possibility of price collusion among societies and among unions. The incentive to engage in collusion comes from the rents to be derived by cooperative officials from depressing producer prices. The governance of the cooperative structure creates ample opportunity for collusion to occur. Society presidents make up union boards of directors, and union presidents largely compose the NWCA board. However, budgets must be approved by general assemblies, composed of all members at the society level and elected representatives at other levels. Ultimately, the pressure to reduce costs must come from members. As long as societies separately determine producer prices and function as residual claimants, the potential exists to increase the income of farmers in any one society by reducing its costs. This exerts a counter-pressure to collusion. Moreover, collusion to hold down producer prices is limited by competition from outside the structure. In order to stay in business cooperatives must perform at least as well as the spot market; otherwise farmers will opt out. Usually this would mean that the cooperatives' initial cash payments to farmers must be competitive with the prices offered by traders.

The other major threat to the design is the need for collective action at the society and union levels in order to maintain quality. Each society faces a potential problem of shirking by individual farmers. Assuming that each farmer wants to get the highest price for the least effort, individually farmers have incentives to evade quality standards. The maintenance of quality depends therefore on the enforcement of standards. If, however, the only pressure felt at the society level is for relaxation of standards, enforcement can be expected to fail. But if farmers benefit collectively from higher quality, there will be a counter-pressure to enforce standards, provided that farmers understand how they benefit. Without being able to track coffee from each society to the world market, however, the members of a society will not benefit collectively from quality control unless unions apply quality standards to societies. This requires that societies act collectively at the union level to maintain quality, reinforced by market signals that derive from tracking union coffee to the point of sale. Collective action is always costly and, therefore, cannot be expected to work perfectly. Although a degree of shirking can be anticipated, the key is that shirking evoke counteractive measures.

### C. Implementing an Institutional Design<sup>7</sup>

Although the prospect of reform held the promise of long-term gain for the entire arabica subsector in NW Province, it first had to overcome the selective, short-term gains of cooperative officials that derived from existing arrangements. NWCA officials unambiguously desired freedom from the marketing board, but they did not wholeheartedly embrace the discipline of the market, including the strictures of a quasi-market design within the cooperative structure. In fact, the process of reform would prove to be difficult and contentious, replete with delays, misunderstandings, and conflict.

With an institutional design in hand, USAID faced the problem of how to introduce market-like arrangements into a cooperative structure not only accustomed to government direction and driven by incentives to inflate costs but also customarily used by local "big men" to derive economic rents through patron-client relationships (Wessen 1994). Secondly, the Mission confronted an immediate problem of how to deliver technical assistance to NWCA, given the decision not to proceed with the CDC proposal. USAID envisioned a 4-year period of reform inside NWCA, parallel to the policy reforms of PRAMS I, with a technical assistance team (under contract to USAID) resident in Bamenda, capital of the NW Province.

The first step was to negotiate an agreement with NWCA, formalized in a Memorandum of Understanding (MOU) and signed in September 1990 by USAID/Cameroon and NWCA together with its 11 cooperative unions. Two issues dominated the discussions.

A minor modification of the design--one to which USAID readily agreed--was that farmers would be obligated to sell coffee to the cooperative in which they held membership but free to withdraw and shift to a different cooperative between marketing seasons. Cooperative membership and the resultant obligation to market coffee through that cooperative would thus be subject to annual enrollment. NWCA argued that this restriction on farmer exit was required to be able to plan the marketing season adequately; clearly, members acquire obligations as well as rights when joining a cooperative. Enforcing the farmer's obligation to sell to the cooperative, however, is a problematic matter; it certainly cannot be taken for granted by the cooperative enterprise, which undoubtedly must depend to a large degree on farmer loyalty--loyalty that has to be earned.

The second and more controversial issue concerned "sitting fees," payments made to the members of governing boards for the time they spend "sitting" as a board. USAID proposed the abolition of sitting fees as part of the cooperative reform. The NWCA board stoutly resisted the requirement, though it resolved to reduce sitting fees by 25 percent.

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<sup>7</sup>This subsection draws in part on the work of Paul Wessen, the PROMT field researcher who observed the reform process in the North West Province between early 1993 and early 1994. See Wessen (1994).

USAID was, obviously, looking for a signal from the board that it was committed to reform and prepared to turn away from rent-seeking, but did not get it.

Instead, the negotiations revealed anxiety and misgivings about the quasi-market features of the design. Too much freedom for farmers, some board members feared, would wreck the cooperative structure. Strong support for the reform plan by NWCA's General Manager, however, helped to convince the board that, with farmer education, reform could work. Board members would continue to stress the need for farmer education throughout the program. Despite reservations, therefore, NWCA agreed to USAID's proposals (sitting fees excepted). Given its fragile position in the midst of a liberalization program already embraced by the government as a condition of its structural adjustment program, argues Paul Wessen (1994), NWCA could hardly do otherwise.

While NWCA's obligations were focused on implementing the quasi-market institutional design, USAID agreed to provide (through a grant to the government of Cameroon) a broad package of technical and economic assistance: (1) technical advice and training related to coffee processing and marketing, in addition to cooperative management, finance, and accounting; (2) institutional advice and training related to reforms; (3) grants to upgrade coffee mills and other equipment and make severance payments to employees let go during restructuring; and (4) a Crop Finance Revolving Fund (CFRF) intended to furnish the cooperative structure with the cash needed to buy coffee from farmers. By arrangement with the US Peace Corps, a group of 11 volunteers were secured to deliver technical assistance at the primary society level, while a resident, 3-person team of technical and institutional specialists would assist union and NWCA management. Moreover, by agreement with the government, USAID would provide financial assistance for the government to pay the arrears owed both to cooperatives and to farmers. USAID's grant agreement with the government also mandated that equipment and facilities owned by the marketing board in Bamenda be transferred to NWCA.

The shift from CDC to USAID-provided technical assistance (TA), however, left the Mission unprepared to deliver a full program of assistance at the onset of the program. Year One of the 4-year project began in September 1990, as soon as the MOU was signed. Because a contract to secure a resident TA team would require several months of preparation, USAID relied initially on short-term TA provided through DFM. This would continue through the 1990-91 market season until early 1992, well into the following season. The first group of 5 Peace Corps volunteers would arrive in the field in early 1991, followed by an additional 6 volunteers late in the same year, both groups for a 2-year assignment. A resident TA team composed of an institutional specialist as team leader, a coffee specialist, and a financial specialist would take up their post in early 1992 for a 2-year period. Because of the timing, the team would be resident in Bamenda only for one full coffee season (1992-93)--each season beginning in November/December and concluding only by late spring or summer. The project was slated for completion in September 1994, though subsequent events would lead to an early closure in June.

The cooperative restructuring component of PRAMS I also included a process of review and assessment that was to be conducted regularly throughout the program. The plan was for one annual and intra-annual reviews each year. Actually, only a single annual review and five intra-annual reviews were held (see Oakerson 1994e for a summary). The conduct of the assessments was contracted to DFM, affording continuity with the earlier design process.

The initial focus of short-term TA as the 1990-91 season approached was on the improvement of coffee quality and the rehabilitation of the 12 coffee mills operated by the cooperative unions. A more rigorous parchment acceptance procedure was devised that would sort parchment into three classes based on observable characteristics. USAID and NWCA signed the first of several annual Program Implementation Agreements (PIAs) intended to specify tasks for Year One. The institutional design was introduced in the form of New Internal Marketing Arrangements (NIMAs), consisting of a set of protocols related to various aspects of the marketing campaign, which were signed by each society, union, and the federation. Key aspects of the design, however, could not yet be implemented. First, NWCA retained its monopsony right and obligation to buy arabica in the NW. Second, the government continued to publish a uniform producer price decree. Both of these limitations were in keeping with the pace of reform outlined in PRAMS I. Third, internal costs could not be separately estimated in advance of the season for each union and society because of insufficient information. Therefore, the cooperative structure continued to operate on the basis of uniform cost estimates for societies and unions, much as under the old system. Policy reform had proceeded far enough that the government granted NWCA an export license to market its entire arabica crop. A Crop Finance Revolving Fund of 267 million FCFA was available to assist NWCA with the purchase of coffee.

As the 1991-92 season approached and the project entered year two, short-term TA continued, expanding its focus to include export marketing and financial management. The marketing consultant strongly recommended that NWCA market its coffee entirely through brokers rather than dealing with world buyers directly. USAID accepted this position, as much out of a concern for transparency in the marketing process as for the greater expertise and market information available from brokers. NWCA, however, initially resisted the idea and, even after the board formally accepted it, the General Manager continued to argue that NWCA should develop its own marketing capability. At the same time, on the financial side, USAID began to pressure NWCA to cut its operating costs at the federation level, again raising the issue of sitting fees and insisting as well on an across-the-board salary reduction of 25 percent. The board finally relented on sitting fees, but it refused to adopt an across-the-board approach to reducing its salary costs, which were clearly inflated, instead following the General Manager's recommendation that it wait to receive consultant recommendations--part of the TA package still to come--on staff reorganization and reduction.

December 1991 saw the first (and only) annual review--a 3-day affair with more than 200 participants. It was an important event in the life of the project, for it was the first occasion at which representatives of all three levels of the cooperative structure (including farmer representatives who were not cooperative officials) gathered to hear and discuss the institutional design for reform previously approved by the board of directors. Key portions of the presentation by DFM consultants were translated into the pidgin English spoken by farmers. The basic ideas on which reform was predicated were met with enthusiasm, punctuated only occasionally by skepticism. Overall, the mood of the meeting was optimistic, anticipating a new era of marketing freedom to be ushered in by PRAMS I.

Serious difficulties lay just ahead, however. NWCA found itself unable to replenish the revolving fund it had used to purchase coffee the previous season due to late coffee sales. Because the agreement with USAID required NWCA to replenish the fund fully before accessing it again, the cooperative structure lacked cash to pay farmers as the 1991-92 season opened, damaging the cooperatives' credibility just as reform was getting underway. USAID began to push the idea that the fund should be commercialized--administered by commercial banks and loaned to NWCA at commercial rates of interest. The controversy, added on top of the still simmering dispute concerning brokers and the slow pace of cost reduction, caused a further deterioration in the working relationship between USAID and NWCA. By early 1992 the relationship had become adversarial.

This was the situation as the long-term TA team arrived in Bamenda in March 1992, along with an additional 6 Peace Corps volunteers (PCVs). They faced a tough assignment. The 1991-92 season was fast disappearing behind them, and year three of a 4-year project lay just ahead. There was a great deal of research and analysis to be done before the institutional design could be fully implemented. In particular, cost studies had to be conducted for each union and society. Moreover, the team had to overcome NWCA's growing resistance to USAID's increasingly insistent stance on key issues, especially commercialization of the revolving fund. Both the TA team and the PCVs, supplemented by a stream of short-term consultants, worked hard to prepare for full implementation of the internal marketing arrangements in the 1992-93 season. Yet, by the time the season was approaching in late 1992, the project was in a state of deadlock.

Between mid-1991 and mid-1992, there was a complete turnover of USAID/Cameroon personnel dealing with PRAMS I, including the Mission Director and Deputy Director, PRAMS I Project Officer (also the Mission Economist), and Project Design and Evaluation Officer, as well as the arrival of a new full-time project coordinator. No one remained at the Mission from the design phase of the project. A new crew faced a developing crisis in the cooperative restructuring component of PRAMS I during the months many of them were learning the design of the program. Some level of conflict occurred among virtually all participants--the NWCA Board and General Manager, the TA team, PCVs, USAID program personnel, and DFM's institutional analyst. Yet, between April 1992 and March 1993 two project reviews that would have been conducted, according to original plans, did not take place, due in part to political disruptions in the NW Province.



The major sticking point in negotiations leading up to the PIA for year three was also an essential point in the implementation of the quasi-market design: society-level producer pricing. NWCA argued that societies and farmers were insufficiently prepared to take this crucial step. Many board members feared that it would lead to "chaos" within the cooperative structure, as societies set prices in a willy-nilly fashion and farmers abandoned their traditional societies for others that offered a better price, perhaps unjustified by real cost differences. The TA team, strongly supported by PCVs in the field, countered that societies were ready and able to play their full role in the new internal marketing arrangements. USAID was able to resolve the deadlock only by deferring society-level producer pricing to year four, with a program of farmer education to be undertaken during year three. As it turned out, a major glitch in national-level policy reform delayed full price liberalization until the following year as well, leaving uniform producer prices in effect through the 1992-93 season.

USAID was deeply concerned that NWCA and the TA team establish an effective working relationship. NWCA complained that the team's working style was isolated and uncollaborative, as well as unnecessarily confrontational. The new PIA required both parties to work together in developing a series of joint action plans. In addition, USAID dropped its former insistence that NWCA use brokers to market coffee, clearing the way for a major TA effort to upgrade NWCA's in-house marketing capability. The major unresolved point of contention was commercialization of the revolving fund--now at 750 million FCFA. NWCA continued to stonewall this change, buttressed by a fortuitous interest-free loan in the amount of 500 million FCFA from the European Development Fund (EDF).<sup>8</sup>

The process of review and assessment resumed in May 1993 after a one-year hiatus. Intra-annual reviews were intended to focus on the progress being made in implementing each year's PIA. Due to a number of factors, the May meeting marked a turning point in the reform program. Considerable progress was reported on several joint action plans, especially in the areas of export marketing and financial management and accounting. A series of meetings between NWCA and the TA team under the auspices of USAID had begun to ease the standoff, and a thorough discussion of remaining differences at the review seemed to clear the air. Moreover, an external evaluation of EDF development assistance in the NW had cast doubt on future EDF support for NWCA, perhaps renewing NWCA's interest in the revolving fund. By the next intra-annual review in September, the critical action-plan for an education campaign on producer-pricing had been prepared, and the board indicated its readiness to proceed with implementation. At the November review, entering on year four, NWCA stood on the threshold of a fully implemented reform program.

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<sup>8</sup>The EC had long been active in rural development in the NW Province, and its field representative continued as a key advisor to NWCA during most of PRAMS I.

## **D. An Assessment of the NWCA Reforms**

An assessment of the cooperative restructuring component of PRAMS I must examine three issues: (1) the process of reform, including the planning and conduct of the reform program to assist NWCA; (2) the performance of the new institutional design once reform was complete; and (3) the choice of the cooperative structure as an institutional focus of assistance.

### ***I. Assessing the Process of Reform***

Of equal interest with the performance of the new institutional design for marketing coffee through NWCA is the reform process by which the new design was introduced. A workable design that cannot successfully be introduced would provide a poor basis for reform--theoretically correct but contextually inappropriate. Yet, the process of reform is inherently problematic, and it should not surprise that the reform of NWCA was plagued with difficulties, for reform requires that the vested interests well served by an old regime be overcome. It requires new ways of thinking. It requires individuals to adopt strategies that are not just different but often unfamiliar. It requires that an expected aggregate payoff that lies in the future be preferred to a continuation of the status quo. Although the future payoff is expected to be larger than the payoff from present arrangements, its distribution is uncertain. The prospect of reform leaves stakeholders in the old regime, many of whom must be willing to cooperate in order to bring about reform, with hard choices to make.

It was predictable, therefore, that reform would meet with resistance inside NWCA--resistance that would continue even as reform progressed. From a donor standpoint the relevant issue is how to respond to resistance and conflict in ways that keep the necessary parties on the path of reform. Two program instruments appear, from this experience, to be crucial. The first is meaningful dialogue--an ongoing discussion of the means and ends of reform. The second is carefully limited conditionality--the enforcement of the key institutional elements of reform (and only those elements) as a condition of continued assistance. The process of reform provides both positive and negative examples in support of these two points.

The importance of dialogue derives from the need for a common understanding, among those who must carry out reform, of (a) the aggregate benefit at which reform aims and (b) the institutional means necessary to achieve it. Growth of the arabica subsector in the NW Province was the aim of NWCA reform, and it had to be the end-in-view for all key participants. Growth, measured by the market value of the total arabica crop, would make the entire NW arabica subsector better off--not only farmers but all producers and managers along the chain of production. Farmers, however, were the key to growth, and producer price was the key to farmers' productivity. DFM and USAID presentations to cooperative officials repeatedly stressed putting "more money in farmers' pockets." This would depend on an ability to control operating costs. The institutional means for attaining cost control were the new internal marketing arrangements (NIMAs) tied to variable producer pricing at the society

level. As a particular society's (or union's) costs would increase, its own farmers would suffer a corresponding reduction of price, creating a strong demand for cost control at the base of the cooperative structure. It was critically important for decision-makers in the cooperatives to understand that the purpose of this new system was to control costs, in order to put "more money in farmers' pockets," in order to promote the growth of the provincial subsector.

The NIMAs, however, contradicted the standard normative image of a cooperative widely shared by NW cooperative officials and managers. The prevailing norm was based on the principle of mutual aid: "one for all and all for one" was NWCA's official motto. The principle was extended, not only to farmers within each marketing society, but also to relationships among societies and unions within the NWCA federation. The NIMAs, by contrast, required that each cooperative organization, at each level, be responsible for its financial independence, covering its own costs. The new principle was one of self-reliance in the context of self-governance. This did not disallow mutual aid, but it did discipline the process by making explicit any decision to subsidize one part of the structure at the expense of others.

Reconciling the new principles with the long-accepted motto and, more generally, developing a common understanding of the relationship between the means and ends of reform, required extensive, on-going dialogue. In the beginning of the project there was clearly too little dialogue as both USAID and NWCA were understandably eager to get on with the project given rapidly deteriorating conditions in the subsector and deadlines established by the structural adjustment program. It was important to act quickly before farmers gave up on coffee and cut down their trees in order to make space for paying crops--and before private traders would be introduced, undercutting the cooperative structure. The success of the annual review held at the end of year one contrasts sharply with the subsequent deterioration of working relationships. Nevertheless, as misunderstandings began to develop in year two, the process of review and assessment was in effect suspended. When it was re-established, a series of three reviews during year three kept the ends and means of reform clearly in front of the key actors--at least at the union and federation levels. Moreover, a seminar on the principles of reform for three senior staff members of NWCA held in the United States seemed to strengthen the commitment of the organization to carry through with the reform program. Despite early shortcomings, it was persistence in dialogue that finally lifted the program past its hurdles to a successful conclusion.

Dialogue alone, however, is often insufficient to secure reform. USAID's assistance to NWCA was based on a quid pro quo--technical and financial assistance in exchange for reform. Donors have no defensible rationale for providing technical assistance without a commitment to reform, for it is reform that makes the investment in technical improvements sustainable and, thus, advances the cause of development. The commitment, however, must be sustained through a period of transition, during which time the reforms are not fully in place. Until reform is well established, it remains highly vulnerable to attack by stakeholders

in the old regime who retain positions of authority. For this reason donors must be prepared to insist that the commitment to reform be kept and to withdraw assistance if the path of reform is abandoned.

Conditionality in fact became a source of often acrimonious conflict between USAID and NWCA during the course of the reform program. Early on, USAID tried to pressure NWCA into cost-cutting measures that it found especially distasteful. USAID made a determined effort to require NWCA to market its coffee through brokers but later backed off this demand. The TA team sought to commit NWCA to a "profit center" approach backed by user fees for all of the support services it provided to unions, including engineering and audit services; NWCA resisted this idea, preferring to provide most services across the board to all unions. Commercialization of the crop finance revolving fund, the most durable source of conflict, was in fact never carried out. However, by year four of the program NWCA was apparently in a position to obtain conventional bank financing.

The effective use of conditionality to support reform depends on making a clear distinction between (a) institutional changes to which a clear commitment is required and (b) changes expected to follow from reform. The NWCA experience illustrates the distinction nicely. For example, USAID's efforts to pressure NWCA directly to reduce costs lay outside the parameters of institutional change. Cost reduction and control were expected responses to reform, not the stuff of reform itself. Although USAID was perhaps justified in seeking indications of good faith from NWCA, such as the elimination of sitting fees, the ensuing debate drove out discussion of more fundamental institutional issues that urgently needed dialogue. Still, the problem lay much deeper in the structure of the program.

USAID faced a basic dilemma at the outset. While the full implementation of reform necessarily lay at least two years in the future, the need for NWCA to make changes that would reduce costs was immediate. Yet, by temporarily sheltering NWCA from competition in order to create an opportunity for change, USAID had reduced the immediate pressure for change, including cost-reduction measures. What to do?

Commercialization of the revolving fund was the answer that USAID came to embrace. The fund was a transitional institution. Its purpose was to ease NWCA through a period when its financial condition would preclude conventional bank financing. Some such arrangement became necessary when CDC financing was no longer in the offing. Transitional arrangements, just like permanent reforms, require careful institutional design.<sup>9</sup> Initially, the revolving fund was designed so that NWCA had access to the fund, for crop financing only, on an interest-free basis, provided that the fund had been fully replenished from the previous year. USAID resolutely held to this condition in spite of heavy pressure from NWCA to relax it. However, USAID would also conclude that the fund was not well designed.

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<sup>9</sup>In the FSSRP, for example, well-designed transitional financing arrangements figured prominently in the success of that program. See Section IV of this report.

Thereafter, it sought to commercialize the fund so that NWCA would experience the time-cost of borrowing, increasing its incentive to market coffee in a timely manner. USAID eventually came to the conclusion that the commercialization of the fund was the key to overcoming the adversarial relationship that had developed between USAID and NWCA over a range of issues. As a transitional institution, the rules of access to the fund as applied and enforced by commercial banks could create incentives for NWCA to reduce costs and operate more efficiently. This, in turn, would relieve USAID of the need to apply direct management pressure on NWCA.

Unfortunately, commercialization proved impossible to introduce once the project was underway. Indeed, the controversy over the revolving fund simply made the situation worse. NWCA's ability to hold out on this issue was buttressed at a key point by the availability of financing through the EDF. The failure to commercialize the fund, however, would not turn out to be a fatal error.

On other issues, such as, especially, the use of brokers, conditionality was applied in ways that, in retrospect, seem inconsistent with institutionalism. How to go about marketing coffee is a management decision--not an element of institutional reform--a decision that should have been left to NWCA's discretion. USAID's concern with transparent decision-making, which in great part motivated their position on brokers, could only be addressed in a sustainable way through institutional reform. Similarly, the use of "profit centers" to organize the provision of support services is a management option, one that NWCA should be free to adopt or reject as it chooses. On management issues, the responsibility of TA in a reform program is to advise, not enforce.

The key issue on which USAID had to stick to its guns during the course of reform was society-level producer pricing. Not a management issue concerned with the operation of any single cooperative organization, this was a basic institutional issue, one central to defining the interorganizational relationships that were constitutive of the cooperative structure. It was precisely the sort of issue to which a clear and sustained commitment is both important and problematic. When USAID allowed NWCA to enter upon Year Three of the program without implementing the producer pricing component of reform, the Mission was roundly criticized by PCVs and others in the field. USAID had concluded, however, that the producer pricing system could only be implemented with further dialogue--that there was too much resistance to proceed without taking additional time to acquaint NWCA officials more thoroughly with the idea and, as NWCA was urging, prepare societies more fully for their new responsibilities. Moreover, a glitch in the policy reform process in Yaounde had temporarily stalled the government's planned shift to full price liberalization. USAID did not abandon society-level pricing but only deferred its introduction while continuing to advance the idea on its merits.

Reform, it would seem, never comes easy. In addition to the many difficulties endogenous to the reform process, there were exogenous factors at work in Cameroon, the NW Province, and the arabica subsector that complicated reform immensely. Many of these complications, however, were closely tied to the window of opportunity that made reform

possible in the first place. Over the period of reform, for example, world coffee prices continued to plummet, wiping out any immediate payoff from the sacrifices being made to bring about reform. When NWCA cut its costs, farmers experienced still lower prices due to continued market deterioration. Benefits lay in an uncertain future. Nevertheless, without a world market in decline, the Cameroonian government would have been much less interested in embarking on a course of reform to begin with. In a related vein, the reform process was often disrupted by political turmoil, fed by economic adversity and the quest for greater, more democratic accountability. For a time, government opponents effectively controlled commercial activity and transportation in the NW, often shutting down the local economy for days at a time as a means of political protest that went by the graphic name, "Ghost Town." These protests delayed the introduction of PCVs into the field and contributed to the temporary suspension of the process of review and assessment, all the while making it more difficult for NWCA simply to conduct business. The various disruptions, while exogenous to the reform program, are clearly endogenous to the circumstances that give rise to reform. It may well be an axiom of policy reform that it always must occur under burdensome economic, if not political, conditions.

## **2. *Performance of the Institutional Design***

Because the institutional design was not fully implemented until the 1993-94 marketing season (just finished at this writing), it is possible to comment on the performance of the design in only a preliminary and provisional way. It was not until year four of the program that the various strands of policy reform came together with NWCA reforms so as to permit full implementation. This was the first year that NWCA faced competition; the first year without a government price decree; the first year under a new national cooperative law that greatly liberalized the relationship of farmers to their cooperatives; and the first year with variable internal costs and producer prices within the cooperative structure. It was also a year when a 50 percent devaluation of the CFA Franc would finally take place, much to the benefit of export sector, and the world coffee market would at last reach bottom and begin a recovery. When change finally came to the NW arabica subsector, it came fast.

The dissemination and implementation of the new national cooperative law occurred in the fall and winter of 1993-94. The immediate, tangible result in the NW was an increase in the number of primary societies from 40 to 73. Farmers seized on their new freedom to subdivide many of the existing societies during the process of cooperative re-registration required by the new law, re-creating many of the village-level cooperatives prevalent before government-sponsored amalgamation. The number of societies is expected to continue to grow. Wessen (1994) reports that the process of society formation was not always based on local deliberation and choice, as in a few cases "big men" who held union-level office orchestrated the process, playing on village-level sentiments to advance their own interests. In other areas, however, village-level societies had already been operating informally as so-called "union intervention zones." In these cases, usually located, as Wessen (1994) points out, in the stronger coffee-producing areas, farmers participated assertively in collective decisions to restructure their societies. Clearly, these farmers were seeking more accountable

cooperatives that would be more responsive to their needs. New elections also resulted in considerable turnover among cooperative officials at all levels including the NWCA presidency, which was won by a farmer who never before held a cooperative office.

The new freedom of societies to establish producer prices did result in a price range, although not as great a range as might be expected from the tonnage differences among unions. Across the province society prices ranged from 476 FCFA/kg to 542 FCFA/kg--a difference of 66 FCFA/kg--around a mean for all societies of 519 FCFA/kg. Grouping societies by union, however, reveals considerable differences in producer price variation from one union to another. Only 6 of 11 unions exhibit significant variation, while 5 unions show little or none. Although in one of these cases the lack of variation seems to reflect true costs, in most cases a lack of price variation within a union reflects union dominance in the price-setting process (see Oakerson 1994d and Wessen 1994 for detail).

All of NWCA's societies opened the season in a strong competitive position. The six cooperatives in neighboring West Province had an opening price of 400 FCFA/kg, later increased to 450 FCFA/kg. Individual traders were paying no more. Coffee was beginning to flow from West to NW, reversing a previous (though then illegal) trend. Once internal costs are recalculated following on devaluation, NW farmers will likely receive a second payment of around 200 FCFA/kg. The competitive advantage currently enjoyed by NWCA is a direct result of cost reductions associated with the reform and restructuring program.

Society-level cost reductions, which emerged only in preparation for Year Four, were clearly a response to society-level producer pricing. In anticipation of the new system, most societies cut costs drastically. The federation had previously reduced its costs substantially at the upper tier as part of a programmed restructuring effort, with PRAMS I paying severance expenses for employees who were terminated. Some cost reduction also took place at the union level, again with program support for severance outlays, but including other efforts to trim operating expenses. However, union-level mills are the most costly operations within the cooperative structure and can clearly benefit from further reductions. Wessen (1994) reports that the union response to society-level producer pricing was markedly weaker than the society response, as might be expected. Societies are much more immediately exposed to rival societies than are unions, which are somewhat protected by transportation costs. The union response depends on pressure from societies. This is a secondary institutional effect that can only be expected to be felt in subsequent years.

If the institutional design is successful, it will lead to a reduction in the number of mills operated by unions. Excess mill capacity is presently inflating costs at the union level and subtracting from farmers income. Most of the mills process lower tonnages than needed to fully capture economies of scale; the only solution is to close some mills and consolidate operations. This does not require the consolidation of cooperative unions, as might be supposed. A union can continue to function as a marketing unit while contracting out its hulling and grading operations to another union. This leaves a union free to seek out the most economical arrangement it can find.

That this level of restructuring among unions had not yet occurred by the end of the project was partly by design, partly not. The TA package did not include the development of a blueprint for restructuring mill operations that might be imposed by central decision at the federation level. Instead, the reform program relies on the new institutional design to generate incentives to support restructuring from the bottom up. This will take some time. If the design had been fully in place by year three, as originally planned, TA would have assisted unions with plans to restructure their operations during year four. However, the reform program gave priority to getting the incentives right, viewing technical assistance as a support service that can facilitate the introduction of reform but cannot sustain it. Without the right incentives, technical and organizational changes are unlikely to survive. The incentive structure most likely to arrive at an efficient number of mills (and total mill capacity) is one driven by the interest of farmers in searching out the means to higher producer prices.

It should be emphasized that the institutional design set in place by the end of PRAMS I remains fragile. The program's original intention was sound--to obtain full implementation by year three at the latest, so that program support could be directed at consolidating the reforms. Program support has now been withdrawn. The weakest link in the implementation of the design lies in the relationship between societies and unions. In order for the reforms to work fully as intended, unions must be effectively accountable for their performance to societies. A new period of high world-market prices may blunt the demands of farmers for cost reduction, while a shortage of competent society managers (given the increase in the number of societies) decreases their leverage with unions. Much depends on societies and farmers understanding that excess union costs take money out of farmers' pockets. This was one of the themes of PRAMS I, a theme that may now be muted. Yet, as farmers come to understand how the reformed marketing system works, in contrast to the old marketing-board arrangements, the cooperative structure provides means for them to assert their interests. To the extent that the cooperative structure inflates its costs, entrepreneurs can be expected to perceive opportunities to enter the local market. This will both allow farmers to take their business elsewhere and facilitate their economic education in how to use the cooperative structure to their full advantage.

### **3. *Assessing the Decision to Assist NWCA***

The cooperative restructuring component of PRAMS I has been criticized for a number of alleged shortcomings. In particular, the transitional maintenance of monopsony privileges combined with USAID's decision to focus on NWCA as a target of assistance, rather than providing more general assistance to any and all business entrants into the arabica subsector, were both seen as inconsistent with market liberalization and privatization--the stated aims of the program. Propping up a monopsonist, it was argued, is not liberalization, nor is assisting one economic actor to the exclusion of all others in a potentially competitive market an effective means of privatization. Did USAID do the right thing or not?



In effect, USAID is criticized for not having supported the rapid emergence of a "spot market" in the purchase of arabica coffee--that is, a highly decentralized market structure in which numerous buyers compete for transactions with many sellers and in which sellers remain free to sell to any buyer at any time. USAID's support of reform for an existing cooperative structure is seen as erecting barriers to a spot market, viewed, implicitly, as "real" privatization. Explicitly, USAID sought to preserve the cooperative structure, if possible, as a means of reducing the social costs of liberalization. Ample research indicates that the absence of effective community institutions is often a serious obstacle to development (see E. Ostrom, Schroeder, and Wynne 1993: 190). The question reduces to this: would a spot market perform better than a cooperative structure in linking arabica growers to the international market?

The answer depends on the nature of the good. Coffee is one of a class of agricultural commodities characterized by "hidden" quality. Others include tea, for example, and sugar in terms of its sucrose content. When coffee is initially purchased from its primary producers, its quality is to a significant extent unknown to the buyer (and perhaps to the seller as well). Coffee quality can only be discerned after roasting--in the cup. This occurs mostly post-export, several stages of production after coffee has left the farm. Roasters employ sophisticated cup-tasting techniques to measure the quality attributes of the coffee they use in various blends. Because of the way it is initially processed, washed arabica is more exposed than robusta to the uncertainties associated with hidden quality.

As developed by Robert H. Bates (1989), the economic problem is how to satisfy the demand for high quality when quality is hidden at the point of initial sale. The lack of quality information at this point disables ordinary market relationships. Because buyers are unable to discriminate between commodities of different quality levels, higher-quality producers cannot be rewarded with a higher price. As Bates (1989:76) explains, the market solution to the quality problem is to "generate a dispersion of prices," but markets cannot work when buyers lack the relevant information. Coffee roasters, who have the primary incentive to seek out good quality coffee, therefore need to modify or supplement ordinary market relationships in the procurement of coffee beans.

In general, the institutional solution depends on some type and degree of vertical coordination in the relationship between primary producers and those who organize subsequent stages of production. Solutions can vary with different commodities and local circumstances.<sup>10</sup> Three basic institutional arrangements offer the potential for vertical coordination:

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<sup>10</sup>Bates (1989: 76-78) discusses differences among coffee, tea, and sugar in Kenya.

- *Parastatal organization*, which draws on the powers of government to license, regulate, and finance primary producers. In this case, as Bates (1989:77) notes, bureaucratic controls replace market forces as the regulatory mechanism for ensuring quality.
- *Contract farming*, in which a private entrepreneur enters into long-term contractual relationships with a number of primary producers. Farmers agree to accept contractual stipulations in their farm practices in exchange for a guaranteed market at a minimum price. Contract farming can also be (and frequently is) combined with parastatal organization, in which case a government-owned enterprise contracts with primary producers and enjoys a protected monopsonist position.
- *Cooperative organization*, in which primary producers form a marketing cooperative able to regulate production practices and export their produce.

Parastatal organization displaces market organization, while both contract farming and marketing cooperatives can develop within a free-market context. Nevertheless, both contract farming and cooperatives modify and restrain ordinary market dynamics. In a spot market conditions of free entry and exit prevail between each discrete transaction; therefore, there tend to be few long-term relationships between buyers and sellers. Spot markets maximize the discretion of both buyer and seller while minimizing the market power of any one participant. Both contract farming and cooperatives are built on long-term relationships that constrain entry and exit. The advantage of a spot market is strong competition spurred on by many buyers and many sellers, but this advantage has to be traded off against the advantage of vertical coordination offered by institutional alternatives.

Although parastatal organization also offers the potential for vertical coordination, PRAMS I represented a clear rejection of the parastatal alternative, based on experience in Cameroon and throughout sub-Saharan Africa. Parastatals tend to suffer greatly from political interference and bureaucratic rent-seeking. Monopsony positions insulate government-owned enterprises from market discipline and encourage lax management. Whatever advantage parastatals offer in terms of vertical coordination must be discounted--and often is overwhelmed--by institutional disincentives to operate efficiently. The whole purpose of policy reform can be viewed as an effort to find a less bureaucratic alternative to parastatal organization.

A spot market, however, seems unlikely to be the preferred alternative in the case of arabica coffee. Arabica is sought mainly for its quality attributes. Without an ability to control quality the growth of the arabica subsector would surely be stunted.<sup>11</sup> A spot market does not permit the sort of long-term relationship between primary producers and exporters

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<sup>11</sup>This does not necessarily require premium quality or quality attributes unique to Cameroon.

that would enable exporters to develop a reputation for high quality. Instead, if private traders were the sole buyers of coffee, they would tend to offer prices that include a discount for uncertain quality. As owners of the coffee, they would pocket any residual benefit from quality improvement, but they would have no ability to promote quality improvement in the absence of long-term relationships with farmers. Private exporters, however, would have incentives to establish such long-term relationships. This would lead directly to contract farming. From this line of reasoning, a spot market is unlikely to be sustained as the predominant arrangement for linking farmers to the international market for arabica coffee.

Robusta coffee is a different matter. PRAMS I was focused exclusively on arabica. The design of a PRAMS II, focused on robusta and cocoa, would have faced quite a different set of circumstances. Early restructuring efforts in the robusta subsector, supported by the French government in cooperation with the World Bank, pointed rather strongly to the emergence of a spot market. Preliminary, informal discussions between DFM and the Mission gave consideration to a more generalized program of assistance to coffee traders, processors, and exporters, not specifically targeted to cooperatives.

For arabica, the effective alternatives are cooperative organization and contract farming. Both have a long and checkered history in sub-Saharan Africa. Cooperatives face some of the same difficulties associated with parastatal organization and must overcome threats to collective action. Contract farming, too, has disadvantages--high initial transaction costs followed by the continuing costs of monitoring and enforcement. The lack of a respected law of contracts together with generally high contract enforcement costs caused by unreliable courts tend to undermine contract farming in Africa, especially in the absence of a protected share of the market (see Little and Watts 1994). It is conceivable, however, that these obstacles could be overcome by a local village "big man" able to dominate local farmers and force them to accept his terms. Yet, such an arrangement could scarcely provide for long-term, sustainable development, at least not on an equitable basis.

This leaves cooperatives--around the world, the predominant organizational link between coffee farmers and the international market. Although Bates (1989:76-78) argues the case for vertical coordination largely in terms of vertical *integration* through hierarchy, the necessary condition for coordination is not hierarchy, specifically, but some arrangement for collective action generally. Although hierarchy, a relationship among unequals, is one way to obtain collective action, collective action can also occur among equals, such as the members of a cooperative, when they have the ability to act with reciprocity (Oakerson 1988) including the option of recourse to enforcement. Cooperatives have the potential to develop these capabilities and are therefore a good candidate for organizing the marketing of arabica coffee.

The weakness of cooperatives, compared to contract farming, is the lack of a profit motive clearly tied to efficient performance by the cooperative enterprise. The greater is farmer loyalty to their cooperative, the weaker the motivation of cooperative officials to compete for their business by holding down costs. Entrepreneurs who sign long-term contracts with farmers are residual claimants who have strong incentives to operate

efficiently; however, they also have incentives to buy as cheaply as possible from farmers. The institutional design for NWCA sought to address the weaknesses of cooperative organization by creating quasi-market relationships within the cooperative structure, increasing the leverage of individual farmers while retaining the ability to act collectively.

The NW Province had been endowed with a cooperative structure that, historically at least, developed in response to farmer initiative. This was viewed as a potentially valuable source of social capital not to be squandered by suddenly unleashing private traders with cash in hand. The creation of market-like arrangements within an existing cooperative structure, rather than the creation of a spot market, became the principal focus of privatization in PRAMS I. In order to make the time needed to introduce a new institutional design and render NWCA fit for market competition, it was deemed prudent to protect its market share for a brief, transitional period. Thus, NWCA's monopsony position was retained for two more seasons, as reform moved along.

The key factor distinguishing the arabica subsector is the problem of quality. Even within an institutional arrangement that permits vertical coordination, quality remains problematic. Coordination, after all, is costly, requiring time and effort. Within cooperatives, the incentive of individual producers to shirk on quality must be overcome--through information, education, control procedures, and the enforcement of standards. Cooperatives face the same difficulty when they accept coffee that a trader faces--the hidden nature of many quality attributes. However, arabica parchment does have some discernible features that seem to be correlated with, though not identical to, quality in the cup. These characteristics can be checked, and farmers rewarded or penalized, through the use of rigorous acceptance procedures. The key is then to follow up with the provision of information and education--traditional cooperative activities that farmers (who understand how arabica marketing works) have incentives to support, reasoning as follows: "The better the coffee my neighbors are producing, the stronger the reputation of my cooperative's coffee." Cooperatives can also devise rules for husbandry and farm-level processing and monitor performance, perhaps randomly, though the NWCA cooperatives have not yet taken this additional step.

Quality control and cost control were the twin themes of the cooperative restructuring project from its inception. During year two, however, the TA effort de-emphasized quality concerns as it struggled with more pressing issues. The emphasis was restored in year three, with renewed attention given to parchment acceptance. During the season, NWCA received a number of quality claims from world buyers--monetary claims that subtracted significantly from sales revenues. This prompted the federation to launch a Coffee Quality Improvement Program with a strong component of farmer education. As PRAMS I was ending, the cooperative structure was increasingly absorbed with the problem of quality, indicating that the *raison d'être* of the decision to assist NWCA had validity.

Still, the possibility that NWCA might fail has not been eliminated. Reform, fully operational for only a single season, remains fragile. One positive feature of the new institutional design, if it is sustained, is that it would allow individual societies or unions to go out of business without jeopardizing the entire structure. Inefficient cooperative organizations within NWCA are less likely to drag others down with them. The federation itself, however, could also fail. If this should happen, some of the larger unions might emerge as exporters, perhaps eventually reconstituting the NWCA or its facsimile. Too much depends on variable time and place circumstances to be able to predict the configuration of the NW arabica subsector exactly. This is one reason that it is important to provide for institutional flexibility.

The policy reforms contained in PRAMS I do not preclude the emergence of any institutional arrangement consistent with market liberalization. Spot markets and contract farming are both free to develop. In fact, cooperatives also participate in spot markets, purchasing coffee from nonmembers or in more distant communities. Numerous NWCA cooperatives bought coffee in neighboring West Province during the recently completed season. The institutional design for NWCA presumed that some degree of spot market activity would impose a competitive constraint on the cooperative structure. If some or all of the cooperatives should stumble, it is still possible that contract farming would emerge in its place or alongside it. The coexistence of different forms of enterprise in the same subsector is not uncommon in sub-Saharan Africa (Jaffee 1994: 107-108). The discretion of economic actors--primary producers, entrepreneurs, investors--to choose among alternative forms of enterprise is at least as important as the discretion of consumers to choose among competing enterprises. The ability to constitute different forms of enterprise enables market participants to structure an industry in ways adapted to the particular nature of the good as well as the more variable circumstances of time and place.

### III. INTERSECTING PATHS OF REFORM

The reform of NWCA, as interesting and important as it was, was only a subtext of policy reform writ large. Changes at NWCA depended on basic changes in the policy regimes that governed both the arabica subsector and cooperatives more generally. These policy reforms sought independently of change in the NW province. The actual outcomes of PRAMS I resulted from the convergence of several different reform paths. First, there were the key reforms made conditions precedent to the disbursement of dollars in the PRAMS I program grant agreement, including the granting of export rights to private parties, producer price liberalization, and the elimination of monopsony privileges, all confined to the arabica subsector. Second, there was the restructuring and eventual abolition of the National Produce Marketing Board (NPMB)--not a condition precedent in PRAMS I and of much broader implication than the arabica subsector. Third, there was the reform of the national cooperative law, which had still broader implications for economic organization in a broad range of commodity subsectors. USAID was the principal donor active in the PRAMS I reforms and assumed a leadership role in cooperative legal reform, but it was mostly an interested (and enthusiastic) spectator in the process that led to the demise of NPMB.

The process of donor-assisted policy reform in sub-Saharan Africa is an institutional dynamic about which little is known--not, at least, in a systematic way. Donors and lenders use sophisticated macroeconomic modeling to diagnose economic weaknesses and chart the goals of economic liberalization and structural adjustment. Because economists understand tolerably well how healthy economies work and, in a technical sense, how to make unhealthy economies work better, economic analysis is able to generate a set of objectives that become the intended outcomes of policy reform. Donors attempt to secure these outcomes by means of specific conditionalities, written into the contractual terms of a grant or loan. Yet, as donors posit objectives and select conditionalities, they do so without systematically modeling the process that leads from an initial policy intervention to intended or expected outcomes. What has been missing in policy reform planning is a persuasive theory of the policy reform process. Without an ability to model the reform process, program planners have little analytic basis for selecting particular conditionalities and anticipating the many difficulties that seem sure to follow.

One of the distinguishing features of USAID/Cameroon's approach to policy reform was its vigilant effort to monitor the process along the entire path of reform. Instead of simply introducing reform and monitoring the outcome, events that occur at the two ends of a reform path, USAID was prepared to intervene at points both foreseen and unforeseen along the way as well as to make mid-course adjustments. Their work provided an unusual opportunity to study the path of reform as it unfolded.

Of principal interest in the study of the reform *process* are the *obstacles to reform* that emerge along the way. Following an initial intervention, what happens that gets in the way, threatening to divert reform from its objectives? What are the sources of these obstacles? How do they arise? How are they countered? To what extent can specific obstacles be

anticipated and addressed in advance? To what extent can they be known and resolved only as they arise? Can the various obstacles that emerge to define the path of reform be explained in a systematic way, one that also affords guidance to donors in shaping their role in the policy reform process? These are the questions to be explored through the examination of arabica-subsector and cooperative-law policy reforms in this section.

#### **A. Policy Reform in the Arabica Subsector<sup>12</sup>**

The design and negotiation of PRAMS I was required to fit a set of parameters defined by AID/Washington, Cameroon's structural adjustment program as set forth in SAL-I, and the position of the Cameroonian government. SAL-I took a cautious approach to marketing reform, not contemplating a fully liberalized system but reserving important operational roles for government agencies in the key export crop subsectors of arabica and robusta coffee and cocoa. In particular, the GRC would continue to issue price decrees establishing a producer price floor and, in close cooperation with the industry, maintain a stabilization fund. The World Bank's agenda for reform was driven mainly by crisis conditions in the export crop subsectors--massive arrears owed to producers and the lack of capital to finance future marketing seasons. To correct this situation, the Bank sought to "get the prices right" by reducing producer prices and tying them more closely to the world market while bringing down costs of operations. AID/Washington, in contrast, wanted a program that was committed to full liberalization, not simply addressing the present crisis by modifying government policies but fundamentally and permanently altering the role of government. Accordingly, in negotiations with the GRC, the Mission carved out a separate program for the arabica subsector, one that pursued a more ambitious reform agenda.

It would prove difficult, however, to negotiate an agreement with the GRC that was acceptable to AID/Washington. The GRC, in particular the Ministry of Commerce and Industry (MINDIC), initially insisted on retaining a stabilization fund. Within the GRC, MINDIC was not interested in devising a separate program for arabica, although the Ministry of Agriculture (MINAGRI) was more open to the possibility. As a strategic matter, USAID chose not to confront the more general issue of a future role for NPMB except to seek a GRC commitment that NPMB would not play any role in pricing or stabilization for arabica--leaving the larger question of NPMB's future open. During negotiations, USAID's tenacity prevailed over MINDIC's opposition. Both MINDIC and MINAGRI would be represented on the Arabica Policy Coordinating Committee (APCC), created by PRAMS I to monitor the process of implementing the agreement under the chairmanship of the Ministry of Plan.

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<sup>12</sup>This subsection draws in part on the work of Daniel Green, who monitored policy reform activities in Yaounde between early 1993 and early 1994. See Green (1994a).

The program grant agreement, signed in a televised ceremony on August 30, 1990, provided for four disbursements, the first in the amount of \$7.5 million and the remaining three for \$3.5 million each. The first three disbursements were to be made quickly: November 1, 1990; January 1, 1991; and April 1, 1991. The fourth disbursement was to occur by January 1, 1993, well ahead of the expected program termination in September 1994. The grant agreement specified conditions that had to be satisfied precedent to each disbursement. As it turned out, only the first disbursement took place on schedule, and the last two disbursements were never made at all. The arabica subsector had, nevertheless, started down a distinctly different path of reform, unlike the restructuring of the robusta and cocoa subsectors, one intended to lead to a fully liberalized marketing arrangement.

One of the conditions precedent to the first disbursement was the payment of arrears owed by NPMB to NWCA and the arabica producers in the NW Province. This was less a policy reform measure than a piece of unfinished business, one that needed to be completed so that NWCA could enter the reform period without owing money to farmers. Even so, it was not an uncomplicated step. It was also absolutely essential, for without the payment of arrears, assistance to NWCA would be futile. Payment depended on achieving a reconciliation of NWCA and NPMB accounts, resolving a series of disputes over the amounts owed. USAID spent considerable staff time on the issue and exercised direct oversight of the reconciliation process, culminating in a three-day marathon session in Bamenda. Payments were made in 3 installments between December 1990 and January 1991, drawing on the EC's Stabex funds (700 million FCFA) as well as PRAMS I monies (1.52 billion FCFA). However, this bit of program success was not viewed with equal favor in all quarters. Government opponents were critical of the move, and the Mission had to face questions from the U.S. Embassy in Cameroon, for the payment of arrears to farmers clearly was useful to the government politically during a period when it was experiencing great pressure for political liberalization.

The policy reforms initiated prior to the first and second disbursements fall into four subsets: (1) export reforms, (2) producer pricing reforms, (3) monopsony conditions, and (4) government supervision of cooperatives, in particular, NWCA. Export reforms included granting an export license to NWCA, eliminating the stabilization fund for arabica coffee, and repealing NPMB's 38 FCFA/kg fee for services (no longer) rendered. Concerning producer prices, the government had agreed to an interim arrangement in which the GRC would consult with the principal arabica marketing agents (UCCAO and NWCA) prior to publishing a uniform price for the subsector. The monopsony privileges of both UCCAO and NWCA were extended for one year, thus setting aside the timetable agreed to earlier with the World Bank. Finally, the government issued policy statements promising managerial autonomy to arabica marketing cooperatives pending a revision of the national cooperative law. Following soon on the heels of the grant agreement, these initial policy-reform steps were relatively unproblematic. Each of them, however, represented only a partial implementation of the full market liberalization at which PRAMS I was aimed.



At this point, PRAMS I was given a somewhat unexpected boost from a parallel path of reform. Earlier, January 1, 1990, under the terms of SAL-I the government had entered into a performance contract with NPMB in which the marketing board pledged itself to a series of policy and management changes, including some stiff austerity measures. At the time, USAID was critical of the contract for not going far enough to reduce the overall responsibilities of NPMB. To be included, however, was a study of NPMB conducted by the Caisse Centrale de Cooperation Economique (CCCE), the French development assistance agency. When released in July, the study recommended that the NPMB be abolished. In December, the GRC signed a 10 billion FCFA loan agreement with the CCCE in which it promised to do just that, leading to the closure of NPMB within a year. In its place, the GRC would create a much smaller agency, the *Office National du Cacao et du Café* (ONCC), with a sharply restricted set of responsibilities, principally in the robusta and cocoa subsectors. This was a structural change that greatly reinforced the extension of export rights to NWCA and other private exporters. Dissolving and liquidating the government export agency not only removed the government completely from the export business but also greatly limited its ability to reassert a government monopoly in the future.

The liquidation of NPMB complicated one element of PRAMS I, however--the transfer of equipment and facilities from NPMB/Bamenda to NWCA. Completion of the transfer was a condition precedent to the third disbursement, but liquidation proceedings delayed the transfer of the NPMB's provincial headquarters--its principal asset in the NW Province--repeatedly. Although the condition was eventually satisfied, and NWCA now occupies the former NPMB offices, the transfer ran more than two years behind schedule. Ultimately, the disbursement would never be made.

At the end of 1991 there was another development in the governance of the robusta and cocoa subsectors, but this one seriously threatened the arabica reforms. The Secretary General for the Ministry of Industrial Development and Commerce (MINDIC) released a draft decree of application for legislation enacted earlier to restructure the export crop sector. The text sounded alarm bells at USAID. Its main deficiency was a total failure to take notice of the special provisions intended to govern the arabica subsector under PRAMS I. The distinction between arabica and robusta was rarely made; blanket references to "coffee" were pervasive. This implied that a common set of arrangements would govern the marketing of both arabica and robusta coffee--including a government-set producer price floor and a commodity based stabilization fund. NWCA's transitional monopsonist position was also in jeopardy. Despite USAID's objections, the decree was promulgated in January 1992.

Over the next few months USAID worked assiduously to obtain modifications in the decree. Other donors, including the World Bank and the CCCE, who had their own objections based largely on an expansion of the government role in the robusta and cocoa subsectors, were consulted. In addition, USAID began to work with the *Comité Interprofessionnel du Café et du Cacao* (CICC), a newly established trade association of

coffee and cocoa exporters,<sup>13</sup> which MINDIC had failed to consult as the decree was being prepared. USAID also used the forum provided by the APCC to press its contention that the decree violated the terms of the PRAMS I grant agreement. In February, USAID organized a meeting of donors and CICC representatives to review a new draft prepared for the Mission by Cameroonian legal consultants. By June, a revised draft was ready for submission to the government, and in August the government issued a new decree based on this draft.

As the 1992-93 marketing season approached, USAID began to prod the government to take the appropriate actions needed for full liberalization of the arabica subsector. In November, a letter from the Mission director to the Minister of Industrial Development and Commerce served to remind the government of the two key conditions: (1) no monopsony privileges and (2) no price decree. USAID suggested further that the government publicly announce that it was abandoning price decrees and, in an additional step, announce that it would no longer open and close arabica marketing campaigns. For several weeks USAID lobbied for such a press release. MINDIC, extremely wary of producer price variation within the subsector, proposed extending the interim system (including the monopsony) for another season.

The issue was not brought to a head until at a meeting of the APCC in January, well after the campaign had unofficially begun. The representative of the Ministry of Agriculture (MINAGRI) pointed out that the new cooperative law, just recently promulgated, made a monopsony extension illegal. The APCC chairman declared accordingly that the monopsony was dead and that MINDIC should issue a communique to that effect. MINDIC indicated acceptance of producer price variation in principle, provided that each buyer announce a price at the beginning of the campaign that would be fixed for the entire season. USAID, knowing that such an arrangement could not be sustained, accepted the position as full liberalization de facto. At the same time, MINDIC began pushing the issue of market information, arguing that farmers needed a reliable source of price information if the arabica market were to function as intended. USAID would later seize upon this argument as a basis for advancing reform.

When a press communique finally appeared at the end of February, it was quite unambiguous in opening the arabica subsector to competition based on producer price variation. It turned out, however, that MINDIC had released the communique prematurely, without consulting MINAGRI or the Prime Minister's Office, both of which had drafts under review. Shortly, MINDIC summoned arabica buyers to a meeting in Douala, Cameroon's major port city, to "examine practical modalities" in implementing the communique. This meeting plus two others had to be aborted, however, for various reasons. At long last, a meeting on April 20, held in the MINDIC ministerial conference room, arranged for a "harmonization" of the producer prices--settling on 200 FCFA/kg. A subsequent communique stressed three points: (1) the arabica-purchasing cooperatives were no longer monopsonists

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<sup>13</sup>Both major arabica exporters, UCCAO and NWCA, were members.

and henceforth would operate in competition with one another; (2) membership in a cooperative obligates the producer to sell to that cooperative, so that only nonmembers are free to sell to any buyer of their choice; and (3) for the 1992-93 campaign, a uniform price would be determined for all arabica buyers. Full liberalization was officially dead for the 1992-93 season. In any event, by this time nearly all parchment coffee had already been purchased from farmers at the announced rate.

USAID quickly turned its full attention to the development of an arabica market information system (AMIS) to accompany price liberalization. By June, a proposal had been accepted by the government. AMIS would be introduced in three phases, supported at the outset from PRAMS I funding. In phase one, beginning in September 1993, the weekly New York "C" price (a world market indicator) and the monthly average FOB Douala price would be announced to the press and broadcast through radio and television media on a weekly basis. Two months later, phase two would add the announcement of prices being offered by buyers in each administrative division where arabica is sold. Phase three, not to be added until the 1994-95 season, would involve the actual collection of data on prices being paid in rural areas.

One issue to be resolved was where to assign administrative responsibility for AMIS within the government. Although MINAGRI made efforts to secure the assignment, in the end it was housed with ONCC, the organizational successor to NPMB. The new administrative unit became a staunch ally and advocate of reform. AMIS was launched on schedule in September with an impressive ceremony, enthusiastically embraced by the government. Its operations began smoothly and continued in that vein throughout the 1993-94 season. AMIS, in fact, became the most visible, public manifestation of policy reform in the arabica subsector. Now the entire country knew that a major change was underway, and they were reminded of it on a weekly basis. In December, MINDIC formally announced the end of fixed, uniform producer prices in the arabica subsector. Full liberalization had arrived—with apparently strong government backing.

## **B. Cooperative Law Reform<sup>14</sup>**

Moving along a parallel path, the reform of the national law on cooperatives was an essential element in the successful liberalization of arabica marketing. However, unlike PRAMS I, which was a subsectoral reform, the new cooperative law was a "crosscutting" reform. Its effects were not confined to a single subsector, nor even to the export crop sector, but embraced a broad range of economic activities, including the production and marketing of local products and the provision of rural credit. Instead of focusing on the institutional arrangements that provide vertical links in the production and marketing of a specific commodity, cooperative law reform was focused on the design of a generic type of institution used to organize economic relationships around a great variety of goods and services. While

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<sup>14</sup>This subsection also draws on Green (1994a).

subsectoral reform is concerned with the adaptation of generic institutional forms, such as cooperatives, to the particular requirements of a specific commodity, cooperative law reform is concerned with the design of the generic form. The shift is a subtle one, but very important--from a concern mainly with making a specific adaptation to a concern with providing for adaptability. The latter requires considerably more restraint of law-makers, enabling individuals to act within broad legal parameters to create appropriate economic organizations instead of prescribing those organizations in detail.

One of the challenges of policy reform, especially at the outset, is that both the institutional arrangements that provide vertical links within subsectors and the institutional arrangements that provide an enabling environment that cuts across subsectors may be changing at the same time. When designing institutional reforms for NWCA, key assumptions had to be made about the forthcoming design of the new cooperative law. In the interim, USAID sought and obtained declarations of intent with respect to the reform of cooperative legislation from the government, but these expressions were quite general in nature. The precise shape of the legislation could not be known until the cooperative restructuring exercise in NW Province was nearing completion. What is more, some important pieces of the NWCA puzzle could not be put in place until the new legislation was fully implemented. From this point forward the existence of known legal parameters--assuming that the legislated changes in the cooperative law are sustained--can be expected to facilitate other cooperative restructuring efforts, as well as help to sustain changes in the NW.

The demand for fundamental reform of the system of cooperatives in Cameroon was broad-based. Disaffection within cooperatives was aroused mainly by excessive government interference in their governance and management, especially on the part of the Department of Cooperation and Mutuality (Coop/Mut) in MinAgri. Increasing difficulties with NPMB also contributed to the unhappiness. Virtually the entire donor community, nearly all of whom had been involved with cooperatives in one way or another over the years, saw cooperative reform as a high priority. A National Cooperative Seminar in July 1988, organized by MinAgri and supported by donors, turned into an assembly of the disaffected that generated an ambitious reform agenda, one envisioning the liberation of the cooperative movement from government control.

SAL-I, signed the following year, gave cooperative reform a critical push by including it in the action-matrix of the program. Although not a condition precedent to any disbursement, its inclusion, with a deadline attached, meant that World Bank monitoring would follow. The deadline of September 1989, however, was wholly unrealistic--especially without a further commitment of donor resources to assist in the process. The reform effort did not get underway in earnest until mid-1990, with support from a UNDP-ILO sponsored project, after a series of draft amendments to the existing law had been proposed by Coop/Mut only to be rejected by the Presidency. USAID entered the reform process in a major way at about this time, responding to a request for assistance from the Minister of Agriculture. Amid uncertainty over whether it would be necessary to draft a new law or amend the existing one, USAID took a strong position that liberalization would require a new

law and that drafting a new law would take time. Ultimately the US position prevailed, and USAID agreed to provide the consulting services needed to facilitate a major piece of legislative craftsmanship.<sup>15</sup>

In fact, a number of donor-supported projects, not only PRAMS I, depended on securing cooperative reform. This led to extraordinary coordination among donors, including GTZ (the German aid organization), CCCE (the French), the World Bank, and the ILO, in addition to USAID. For the most part coordination, both among donors and with the GRC, took place through a joint working group formed to move reform along. The first step was to draft a policy statement, subsequently released by the government, committing the GRC to formalize the working group under the auspices of a joint donor-GRC coordinating committee chaired by the head of MINAGRI's Department of Agricultural Projects (DPA)--notably not Coop/Mut. The working group, composed of donor representatives and MINAGRI staff and usually chaired by DPA's *Chargé d'Etudes*, worked closely with the USAID-provided consultant for the next year, culminating in a national seminar to review a draft law in September 1991. The seminar stimulated a number of improvements, as participants stressed the need to have a law made for farmers rather than lawyers, one that could be easily understood and that would, as much as possible, avoid confusion by combining all other statutes affecting cooperatives.

The next step was submission of the draft legislation to the Prime Minister's office, on its way to the National Assembly. Here, in the Department of Legislative and Regulatory Affairs, it hit a serious snag. Specifically, they found the law much too detailed, containing provisions that should be left to a decree of application under Cameroon's Constitution. In its place, the Prime Minister's office produced their own legislative draft. The donor community responded with expressions of outrage; soon their own analysts had determined that the alternative draft restored much of Coop/Mut's power and gave wide powers of decree over the cooperative movement to the supervisory ministry.

In early 1992 the donors agreed to abandon the earlier draft and submit a new draft to the government. Once again a group composed of donor representatives and MINAGRI officials went to work. This time, the group prepared both a draft law and a decree of application, dividing the previous draft into two separate documents. All procedural matters were placed in the proposed decree. After submission to the Prime Minister's office, with whom the group had been consulting, remaining issues were settled in a high-level meeting between donors and government officials. The draft legislation was enacted by the General Assembly, without further modification, in August 1992. The implementing decree appeared in November.

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<sup>15</sup>Hans Munkner, a German cooperative-law expert strongly recommended by the World Bank, was selected for this assignment.

The new law and decree enable cooperatives to govern themselves within a broad institutional framework. Former government powers to approve appointments of managers and other staff members, which had led to the appointment of civil servants to manage important cooperatives, were absent. While most of the debate during the drafting of the new law centered on the powers that would be retained by government, with many arguing that government needed to exercise supervisory authority in order to ensure probity, the new law reflects a philosophy of self-governance. Instead of relying on a government agency to monitor cooperatives for financial responsibility, the new law internalizes monitoring within each cooperative by requiring each one to form an independent "supervisory committee" with full access to all cooperative documents and accounts and the power to investigate irregularities. The role of government is limited to registration, although all cooperatives must follow specific guidelines in their initial application. Articles of association and the general meetings called to adopt them must be sure to address specific issues. Detailed reporting requirements apply annually. The law also introduces an alternative to the formation of a cooperative, an organization called a common initiative group (CIG). The financial reporting requirements for CIGs are much less stringent, and the external audit required annually of cooperatives is not required of CIGs. The choice of the form of organization lies entirely with the organizing group, with no conditions to be met.

From the beginning the movement for cooperative reform had anticipated a substantial restructuring of Coop/Mut. Early in 1991, however, the department was subjected to a searching review by a team of World Bank consultants. Their final recommendation--to abolish Coop-Mut and replace it with a simple registration service--became part of the working drafts of the cooperative law from that point on. As a result, passage of the new law terminated the agency whose heavy-handed oversight had done so much to motivate reformers.

Reform was not complete with the passage of a new law and decree of application. Implementation required two additional steps: (1) organizing, staffing, and training for the new registration service and (2) a national dissemination campaign, needed to alert cooperative members and officials to the new rules of the game and its requirements. The task of implementation was assigned to a transitional body organized with the help of the UNDP/ILO and funded initially by the World Bank. USAID supported the dissemination campaign financially and by supplying the services of a consultant.<sup>16</sup> By September 1993, the ten cooperative registrars--one for each province--were ready to take up their posts. As long feared by donors, eight of the registrars were former Coop/Mut employees. In fact, this outcome appeared to be unintended but happened because it proved difficult to find qualified candidates, in the locations they were needed, who were not previously part of Coop/Mut.

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<sup>16</sup>Dissemination was delayed by USAID's insistence that a 1978 law giving provincial officials wide powers over cooperatives be repealed. This problem was one of those identified in the national seminar held in September 1991 to review the draft law.

### C. The Combined Effect of Arabica-Subsector and Cooperative Law Reforms<sup>17</sup>

The immediate effect of policy reform in the arabica subsector, together with cooperative law reform, can be gauged by examining changes underway in West Province. Here the *Union Centrale des Coopératives Agricoles de l'Ouest* (UCCAO) and its six member cooperatives, unlike NWCA, had long been free to market its own arabica crop. It was subjected, however, to the same restrictions on cooperative governance and management as well as producer pricing. Because PRAMS I included no special restructuring effort for the UCCAO cooperatives, their response to reform represents a pure institutional effect unadulterated by parallel efforts to redesign the marketing arrangements.

The new cooperative law allowed cooperatives to rid their management of civil servants imposed by the government. All six cooperatives and the Union did so at once, acting on a belief that government employees were insulated from the effects of poor performance. Moreover, the power relationship between UCCAO and its member cooperatives has shifted to the advantage of the six cooperatives. Together, these changes have engendered a flurry of restructuring activity.

The Union experienced a major change of leadership. The 14 civil servants that occupied all top-management positions were terminated as of February 1993. Then, a management committee composed of the six cooperative managers drew up a plan to reorganize UCCAO, reducing its 10-12 departments to four and shedding its workforce by 84 employees, leaving a staff of 101 persons. Several of the member cooperatives have also made major reductions in force, some of which began prior to the recent reforms.

Private competitors have also appeared on the scene. AMIS lists two independent traders operating in the area. A third export company being formed by the former UCCAO General Manager was also said to be operating throughout the province. The greatest competition, however, is coming from NWCA cooperatives, especially those small unions that need additional tonnage to hold down their internal costs. Dan Green reports that UCCAO and member cooperative staff members "console themselves with the idea that the price NWCA is offering is not sustainable and that it will surely drive NWCA out of business in a year or two" (Green 1994b: 73). They seemed to dismiss the idea that NWCA cooperatives might be operating more efficiently, preferring instead to believe, erroneously, that USAID was subsidizing NWCA operations.

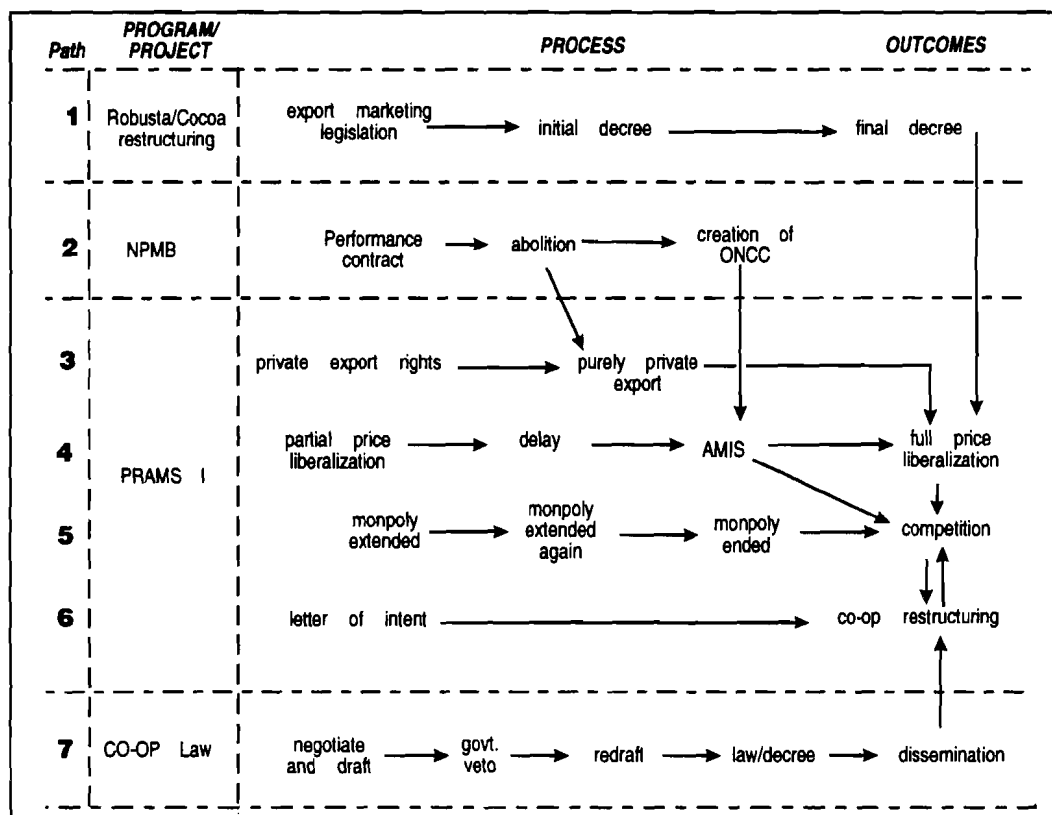
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<sup>17</sup>This subsection is based on fieldwork conducted by Daniel Green and Paul Wessen. See a research note written by Green 1994b).

## D. Understanding the Process of Policy Reform

The reform of the arabica sector followed several paths, which converged in the end to produce the intended outcome (see Figure 1). Each path began with a separately identifiable donor initiative--a distinct point of intervention. Figure 1 shows six initial interventions:

- Path 1: Efforts to restructure the robusta and cocoa sectors.
- Path 2: The signing of a performance contract with NPMB;
- Path 3: The extension of export rights in arabica to private parties;
- Path 4: Partial price liberalization;
- Path 5: The temporary extension of monopsony privileges;
- Path 6: Interim cooperative liberalization through discretionary application of the existing cooperative law to NWCA;
- Path 7: A commitment to reform the cooperative law.



**Figure 1: Paths of Reform Leading to Market Liberalization in the Arabica Sector**



Four of the interventions (Path 2-5 above) lay within the arabica sector and were directly associated with PRAMS I. Although PRAMS I was designed to stand alone, regardless of the success or failure other reform efforts, events along other paths of reform had the potential to retard or advance the cause of arabica liberalization. Two of these initiatives (Path 1 and 6) were broader than PRAMS I and involved other donors. Another (Path 7) was a parallel path of reform in two closely related sectors.

Each path proceeded through a series of decision points, largely within the Cameroonian government. At each point reform could be stalled or reversed. Along two paths--price liberalization and cooperative law reform--reform suffered serious setbacks. Both were overcome.

### *1. Analyzing the Paths of Reform*

The price liberalization path was both central to the reform effort and highly problematic to complete. The decision to begin with partial price liberalization, retaining uniform producer prices while adding consultation with the arabica cooperatives, reflected the weak and ambiguous commitment of the GRC to this objective. USAID understood from the beginning that further discussion and negotiation would be needed to move forward on this path. During the 1992-93 season full liberalization was not so much rejected as it was sabotaged--subverted following a public announcement to the contrary. USAID responded by addressing the government's stated objections--a lack of price information for farmers--and taking them seriously. The result was AMIS, a government administered program to support market liberalization. This was the first expenditure of PRAMS I money on a government program. The rest had been used to support the cooperative restructuring component. AMIS accomplished several things. First, it did supply information not previously available to farmers or the general public in Cameroon. Second, it gave arabica market liberalization much greater visibility in the public eye. Third, and perhaps most important of all, it gave the government a positive role to play, and it gave a government agency a stake, in market liberalization. For the first time, the government began to feel some "ownership" of the policy-reform program. Although there are risks inherent in a sense of ownership by the government, risks that it may overplay its role, the greater risk of reform reversal probably lies in attempting to shut government completely out.

The other paths within the arabica subsector (and explicitly programmed by PRAMS I) were less problematic. The extension of export rights to the private sector, in fact, led unexpectedly to exclusively private export. This happened only because the reform of NPMB--a separate path--led to its abolition. Otherwise, the marketing board potentially would have remained an arabica buyer--competitive with the cooperatives and others. PRAMS I did not attempt to put NPMB out of business, but was designed instead to operate whether or not NPMB remained viable. The temporary retention of monopsonist privileges on the part of NWCA was problematic in the sense that such market restrictions are difficult to enforce. In fact, NWCA lost a significant but unknown quantity of coffee to cooperatives in West Province during the period when it supposedly retained its privilege as sole buyer in

the NW Province. NWCA's efforts to secure enforcement from the government were unsuccessful. Nonetheless, open competition was inhibited, and new entrepreneurs did not attempt to enter the market. Most importantly, no significant problem was encountered in moving to full competitive conditions at the appointed time.

Cooperative law reform, as described above, was highly problematic. The key to success was a high level of coordination among donors and their tenacity in the face of opposition. USAID's role in this process was to press for the most liberal law possible and to supply assistance geared to that end. Donors had important allies within the Ministry of Agriculture. The larger interest of the ministry in the maintenance and growth of export markets and improved agricultural productivity was effectively harnessed to the objective of cooperative reform. While Coop/Mut as a single agency was more or less neutralized in the struggle (thanks largely to the efforts of the World Bank), the reform effort ran into the more general interest of the bureaucratic regime in maintaining its hegemony by means of the power of decree. By confining legislation to generalities, bureaucrats retain the power to shape public policy in a largely unfettered manner. It was the bureaucratic regime writ large that was able initially to veto cooperative reform in the Prime Minister's office. The donor community in effect conceded the point in order to rescue the new cooperative law and the system it sought to introduce.

Finally, there is the parallel path of reform in the robusta and cocoa subsectors. Given MINDIC's initial opposition to a separate program for arabica, USAID was aware that the close relationship between the two coffee subsectors was a likely source of difficulty. Sure enough--efforts to rewrite legislation and, especially, the bureaucratic decree of application proceeded to ignore the elemental distinction between arabica and robusta coffee. In the original decree, coffee was coffee. If allowed to stand, the decree would possibly have doomed price liberalization--including, in particular, the component of price liberalization freeing arabica cooperatives from contributing to a stabilization fund. Participation in a stabilization fund leads inexorably to regulation of producer price. Although the government effort to erase the distinction between arabica and robusta seemed to fade quickly in the face of donor opposition, the threat was a real one that, in the absence of close monitoring and a resolute donor response, would have undermined the reform of the arabica subsector.

The paths of reform extend beyond 1994 when PRAMS I ended. Original plans for a PRAMS II and III are no longer options. USAID believed at the outset of PRAMS I that PRAMS II, extending the arabica-subsector rules to cover robusta and cocoa, was important to the sustainability of arabica marketing reforms. In the long run it seemed doubtful that two widely disparate sets of rules would be allowed to govern such closely related subsectors. In one plausible scenario arabica would simply be absorbed into the robusta-cocoa system, a step foreshadowed by the problems that arose with the coffee and cocoa restructuring decree. The dramatic success of PRAMS I, however, has prompted government interest in the opposite scenario--implementing the vision of PRAMS II without USAID support. The path of reform in the robusta and cocoa subsectors has, in fact, not gone well. Instead of aiming at full market liberalization, the restructuring was intended to improve government

management of the subsectors. Retained were most of the basic features of the old system: government fixed, uniform producer prices and the maintenance of a stabilization fund. Despite efforts to work closely with CICC, the newly formed organization of exporters, the government reportedly has found the system unduly complicated to administer. This assessment is confirmed by the experience of NWCA, which markets a limited amount of robusta coffee. The process of exporting robusta, moving it through the port facilities, has been more uncertain and costly than in the case of arabica, due to the bureaucratic controls and consequent opportunities for delay and corruption retained in the robusta-cocoa system. Consequently, as PRAMS I was drawing to a close, the government began to express interest in extending AMIS to include robusta and cocoa, with the clear implication that greater liberalization was under consideration for these subsectors. By late 1994, the government had announced that these changes would occur. Policy reform in the arabica subsector, although threatened with disaster at numerous points, had become an example worthy of emulation.

## 2. *Toward a Theory of Policy Reform*<sup>18</sup>

Policy reform can be viewed as an economic good--a preferred state of affairs that exhibits scarcity, requires the use of resources and effort to produce, and supplies a stream of benefits to people. Clearly, however, it is not a good like coffee or cocoa. It is not a private good. Nor is it a simple public service, like road repair. Policy reform does, nevertheless, exhibit the character of a collective good, that is, it produces a benefit stream available jointly to a large and somewhat indefinite community of persons over time. In the long run policy reform is expected to make nearly everyone better off; in the short run, however, it requires sacrifice--more from some than from others. To be successful, policy reform depends on a large number of individuals to contribute their discretion to the reform process while passing up opportunities for short-term, personal gain. No one has a clear economic incentive to commit to and participate in such a reform process unless nearly everyone else of relevance is also committed.

The aim of policy reform in the arabica subsector, for example, is the growth of the industry. When the industry grows, all participants in the subsector benefit--farmers, processors, managers and employees of cooperatives, and government agents supplying relevant services (such as market information), as well as government in general through revenue growth. When the industry shrinks, everyone loses. How benefits are distributed within the subsector is a different kind of issue--although one not unrelated to growth.<sup>19</sup> Because the growth of the industry depends on reform, it becomes a collective good.

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<sup>18</sup>The outline of this theory is sketched in Oakerson and Walker (forthcoming).

<sup>19</sup>Recall the earlier discussion concerning the need to be sure that farmers are well rewarded in order to create and maintain incentives to produce.

Policy reform is a process of collective action in which the problem is one of sustaining a course of action through time. Moreover, it is a process that involves large numbers of actors who make a complex series of interrelated decisions. The ability to sustain a collective commitment to such a course of action is highly problematic in the face of strong individual incentives to shirk. The setbacks experienced in the course of policy reform in the arabica subsector, as well as in cooperative law reform more generally, derived from shirking behavior. Although the government had made a commitment to a course of action, this did not automatically deter individuals or groups who were responding to selective benefits. Various government officials used their discretion in efforts to retain governmental prerogatives, including power over producer prices, stabilization funds, and decrees of application. These actions reflect opportunistic strategies to gain or keep selective benefits--especially the power needed to extract rent--at the expense of the general benefit sought through policy reform.

Sub-Saharan governments notoriously lack the ability to sustain long-term commitments to collective endeavors. Without the capacity to act on the basis of long-term common interests, the reformability of any society is questionable. Less developed societies find themselves in an institutional trap--one from which they can see the potential benefit of reform but from which they cannot escape due to the immediate incentives that drive individual behavior. Lacking an endogenous capacity for reform, such societies must rely on exogenous constraints and resources-- if reform is to work.

The theory of policy reform sketched above is suggestive of a donor role--the classic role of the "monitor" in collective action (Alchian and Demsetz 1972). A monitor enables a community of people to obtain a collective good by observing individual behavior and intervening to stop shirking. If policy reform is a collective good, and if sub-Saharan governments are unable to sustain a collective commitment on behalf of a given community of interest, it follows that the process of reform will not succeed unless monitoring is exogenously supplied. Donors are the only possible source of monitoring on the horizon.

Acting as monitors, donors are required to do more than obtain a clear commitment from the host government to a path of reform. They must remain actively engaged in the reform process along the entire path. They must also be prepared to react at any point, vigorously protesting actions that depart from reform commitments. This is exactly what happened in Cameroon when discretionary actions by government officials at various points threatened the commitments made to price liberalization and cooperative reform. The case history of PRAMS I strongly suggests that, without timely donor intervention, the government would have been unable to keep its commitment to reform.

The central programmatic question is how donors and lenders can legitimately and effectively play such a role and, in the process, make what could be a definitive contribution to policy reform in sub-Saharan Africa.

#### IV. THE CONDUCT OF POLICY REFORM: A COMPARATIVE ANALYSIS

Given the nature of the process, policy reform can be conducted well or ill, depending on the approach taken, the factors considered, and the skills and techniques brought to bear in the process. In this section the examination of policy reform in Cameroon is broadened to include a discussion of comparative case studies. Comparative analysis allows us to address questions of relative success and failure, as well as to identify the institutional factors that effective policy reform programs should take into account. The key factors that emerge from the analysis are as follows:

- *The existing design and capacity of the institutional infrastructure needed to complete the transition to free-market arrangements.* The condition of physical infrastructure is a well recognized constraint on development; institutional infrastructure, less so. The latter includes firms of various types (including cooperatives as relevant) that operate at different points in a chain of production and/or distribution or supply various inputs to a production process, plus long-term contractual relationships.
- *The impact of market-level reform on the effect of reforms at the level of specific enterprises, public or private.* Policy reform often proceed by attempting the reform of specific economic enterprises, especially cooperatives or public enterprises. The effect of these enterprise-level reforms depends on complementary market-level reforms that affect the competitive conditions under which enterprises operate. Market-level reforms address such issues as commodity and input pricing, as well as the freedom of competitors to enter the market.
- *The relevance of governance institutions to the feasibility and sustainability of crosscutting reforms.* Governance has to do with the processes for making and applying rules, while crosscutting reforms are those concerned with rules that cut across various economic subsectors, affecting the terms under which the various aspects of any economic transaction can be carried out. Crosscutting rules have to be invoked and applied in highly diverse circumstances on a continuing basis. Therefore, crosscutting reforms will be greatly affected by the governance processes through which individuals invoke rules to be applied and enforced.

Finally, drawing on all of the cases examined in this report, the section concludes with a general discussion of the requirements of an effective approach to policy reform, including both the role of donors and the place of institutional analysis in the conduct of reform.

## **A. Institutional Infrastructure and Market Transitions**

Two key issues bearing on the conduct of policy reform are the role of commodity-specific reforms in the more general context of economic liberalization or structural adjustment and the nature of the transition to free-market arrangements. In addition to PRAMS I, PROMT conducted case studies of two other commodity-specific programs, FSSRP and PSIE, the pair of fertilizer reform programs supported, respectively, by USAID and the EC. A comparative analysis of the two programs yields interesting insights on both issues.<sup>20</sup>

FSSRP and PSIE divided the country between them, with PSIE limited to the three northern provinces. Although both programs shared the same objective, at least nominally, the contrast between them could not be much sharper. The FSSRP successfully completed the transition from a government-administered system of fertilizer procurement and distribution to a free-market arrangement, while PSIE largely re-created the discredited national system on a regional scale. How two programs focused on the same commodity in the same country could reach such different ends is a question well worth a close examination.

The administered system originated with a decision by the GRC in the early 1970s to subsidize the provision of fertilizer to coffee growers. Such subsidies became a common means in sub-Saharan Africa of encouraging the growth of revenue-generating exports. Subsidies required some degree of administrative involvement by the government, an opportunity for bureaucratic expansion that led to a system based on administrative determination of fertilizer needs, centralized procurement, and the allocation of quotas to end-users. When prices are not used to ration a commodity among users, other means become necessary. Even so, the fertilizer industry that developed around this system included a number of "private" actors--importers, transporters, and distributors (mostly cooperatives but including some public enterprises). All, however, were under contract to the rural credit agency charged with the central administrative responsibility. The importers, in particular, were little more than "mail-box" agents who obtained government tenders and arranged for physical importation. They were not entrepreneurs in the economic meaning of the term.

The limited involvement of private actors within the administered system laid no foundation for further privatization, in particular, the introduction of free-market arrangements. Import agents did not establish relationships with transporters or distributors. Their only domestic connection was to the government. In a free-market arrangement, these relationships would need to be built from scratch. Participants in the old system had little

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<sup>20</sup>Case studies of the two fertilizer reform programs were conducted for PROMT by Tjip Walker. See Walker (1994a, 1994b).

social capital of use in the new system. In fact, none of the former import agents would turn out to be among the early successful entrants into the new fertilizer market.<sup>21</sup>

USAID (see Truong and Walker 1990) used the terms "liberalization" to refer to the change in the rules used to govern the fertilizer subsector and "privatization" to refer to the process of entrepreneurship needed to establish not only import firms but also new vertical links between importers and distributors. Although liberalization could proceed rather quickly, privatization, the Mission believed, would take time--time needed for entrepreneurs to establish working relationships and for the market to correct entrepreneurial errors. Markets work not by assuring success but by punishing failures, a process that eliminates ineffective and inefficient firms. The introduction of market arrangements creates opportunities for both success and failure, and market processes inevitably include business failures and economic relationships that, for one reason or another, don't work out. Business failure is not equivalent to market failure. Yet, in an emerging market, too many business failures at the outset leads to market failure--defined in this case as the inability to provide fertilizer during a given crop-year.<sup>22</sup>

These considerations led USAID to design a transitional privatization structure as part of FSSRP--a set of arrangements intended to facilitate the process of entrepreneurship and reduce the potential for error. The privatization structure included four main components: (1) a procedure for gradually phasing out subsidies; (2) the provision of credit at preferential rates of interest to importers and distributors; (3) a commodity pricing policy that yielded sufficient returns to entrepreneurs; and (4) the provision of information to participants in the emerging market. The main institutional puzzle was how to implement the subsidy, as well as the credit program, without continuing the administered system or creating yet another bureaucratic arrangement. The answer was to tie access to the subsidy fund to the use of credit and rely on commercial banks to administer both. Banks, made fully responsible for defaulted loans, had strong incentives to screen applicants for their financial viability, not their political connections. Through this arrangement the subsidy and credit program could be implemented in a manner consistent with market principles.

The PSIE did not create a similar privatization structure. Instead, it relied on a large cotton parastatal, SODECOTON, to administer its program and, eventually, to dominate fertilizer procurement and distribution in the northern provinces. SODECOTON, whose contract farmers were among the principal users of fertilizer in the region, ended up substituting itself for the central agency in an administered system, rather than facilitating the emergence of a private industry. Although liberalization was subsequently extended to cover the entire country, the effect of the more liberal rules, to date, is quite different in the northern provinces.

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<sup>21</sup>Later in the program, USAID reached out to the former importers with special assistance in an effort to give them a stake in the reformed system, expanding the constituency for sustaining free-market arrangements.

<sup>22</sup>Privatization of fertilizer in Senegal, for example, led to the failure of the distribution network.

Policy reform produces changes in the rules affecting an entire commodity subsector, but the effect of those rule changes depends on the existing *institutional infrastructure* within the subsector, a factor that can vary significantly from one part of the country to another. Policy reform makes macro-changes at a subsectoral level--changes that create new opportunities while foreclosing others. However, economic actors, including in this case importers, distributors, and consumers, can respond to the changes differently. The institutional infrastructure for fertilizer distribution in northern Cameroon was dominated by parastatal enterprises, while elsewhere produce marketing cooperatives were the principal distributors. The FSSRP utilized pre-existing institutional infrastructure in the commercial banking sector to replace the bureaucratic infrastructure in the commodity sector, which was deliberately abandoned. The PSIE also utilized pre-existing institutional infrastructure, but not an infrastructure that was compatible with privatization.

The importance of the institutional infrastructure lends support to the conduct of policy reform on a commodity-by-commodity basis. Cross-cutting approaches, while important complements, do not permit the close examination and adjustment of the institutional infrastructure that provides the vertical links in commodity production-and-distribution chains. Yet, the effect of macro-level reform depends on how those linkages are organized. Commodity-based policy reform programs can be designed to include components that directly address the problem of institutional infrastructure. The inclusion of a major effort to assist NW arabica marketing cooperatives in PRAMS I is a prime example. Still, a commodity focus is insufficient by itself. Also required is sound institutional analysis and design. Pre-existing institutional infrastructure that produces incentives incompatible with the aims of reform can deflect reform from its intended path. PRAMS I was concerned not only with the survival of cooperatives in NW Province but also with their efficient performance responsive to the interests of farmers, an objective that depended on basic reform within the cooperative structure. The possibility that NWCA would simply substitute itself for the marketing board, reproducing the same arrangement on a smaller scale, posed a threat to the reform of the arabica subsector. This is roughly what SODECOTON was able to do in the case of fertilizer reform, seriously undercutting the reform effort in the PSIE. It was careful institutional design that, in part, enabled both NWCA and the FSSRP to reach a different result.

These experiences begin to shed light on the process of transition to free-market arrangements more generally. Changes in the operational rules governing the marketing of commodities do not simply "unleash" markets. Instead, such macro-reforms create some new opportunities for entrepreneurship and foreclose others (or make them more difficult). In order to respond to new opportunities, entrepreneurs will have to fashion new institutional infrastructure. To some extent, however, they must also rely on pre-existing infrastructure--this because the process of establishing new relationships among economic actors is always costly. Pre-existing institutional infrastructure that is allowed to stand will inevitably bias the result of policy reform. Yet, all pre-existing infrastructure cannot be destroyed without destroying the subsector (or the economy). This is why the process of policy reform must do more than unleash markets. The creation of new free-market arrangements depends on



careful institutional craftsmanship that fits what is new to what is pre-existing. The process is one that requires time, diagnostic analysis, design, and continued monitoring through a period of transition.

## **B. Enterprise Reform Without Market Reform**

Just as market reform depends on complementary changes in the institutional infrastructure, meaningful and effective reform at the enterprise level may depend on policy reform at the market level. The World Bank's public enterprise reform program provides the case in point.<sup>23</sup> SAL-I assigned a high priority to improving the efficiency of Cameroon's 170 or more state-owned or state-controlled economic enterprises, which together constituted a serious drain on the public treasury. Three options were used: (1) Liquidation was planned for enterprises considered non-viable whether operated in the public or private domain. The others became candidates for (2) divestiture--sale in the private sector--or (3) rehabilitation. All three options have proved to be difficult if not impossible to implement.

*Liquidation and divestiture* are inherently difficult actions to take, especially to do well. Both entail developing an inventory, determining the economic value of what are often highly specific assets (for which no active market exists), finding buyers, and negotiating a sale that maximizes the return to the government. Both are easily subjected to abuse and corruption. The inevitable controversy surrounding the process leads to interminable delays. Although more than fifty liquidations had been ordered by early 1994, only five had been completed (Hinman 1994b: 37). Even so, some liquidators are alleged to have sold assets at a fraction of their value. Don Hinman, who studied public enterprise reform for PROMT, reports that one liquidation team leader explained to him that liquidators have little incentive to preserve assets and sell them at the best possible price (Hinman 1994b: 37).<sup>24</sup> Divestiture has progressed somewhat further, with four out of thirteen public enterprises sold; however, two of those involved only the sale of state-owned shares in joint public-private ventures. Divestiture seems to occupy a narrow and tenuous middle-ground in public-enterprise reform. Hinman (1994b:36) suggests that as long as an enterprise is making money, its supervising ministry is inclined to drag its feet in moving ahead with divestiture; when the enterprise begins to lose money, potential buyers are no longer interested.

The principal mechanism for *rehabilitation* is the negotiation of a performance contract between the government and a public enterprise. The contracts typically stipulate a number of goals related to cost reduction, productivity improvement, and competitiveness. Reorganization and new systems of management were frequently required. For its part, the government is obligated to supply financial assistance to support the process of rehabilitation-

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<sup>23</sup>Case studies of the public enterprise reform program were conducted for PROMT by Donald Hinman (1994b).

<sup>24</sup>Perhaps liquidators should be paid a commission on the price they obtain.

-with the aid of donors. The objective was to make public enterprises into profitable businesses--net suppliers of government revenue--rather than subsidized business failures. The prevailing judgment in both the GRC and the World Bank is that performance contracts have failed to work (Hinman 1994b: 28).

In some ways rehabilitation has moved forward, for example, with significant reductions in the work force and upgrading of processing facilities.<sup>25</sup> Still, the drain on the public treasury continues. Although the direct subsidization of public enterprises has declined (from a high of 150 billion FCFA in 1984 to 12 billion FCFA in 1991), indirect subsidies have proliferated. According to the World Bank (n.d.) the indirect subsidies include exemption from or defaulted payment of taxes and import duties; cancellation of debts by the government; non-payment of employee taxes and social insurance contribution collected by the enterprise; bank overdrafts; non-servicing of external debt; and non-payment of fees for goods and services supplied by other public enterprises (e.g., many public enterprises ignore their obligations to pay for electricity and water).

Public enterprise reform has been an effort to bring about reform at the *enterprise level* without undertaking complementary reforms at the *market level* for the particular commodity. For example, the rehabilitation of SOCAPALM and the Cameroon Development Corporation's oil palm operations was explicitly predicated on the government's maintaining a protected domestic market through price controls. Instead of relying on competition to generate the incentives to reduce costs, the government tries to suppress competition while attempting to "buy" cost reduction and efficiency gain--often with donor money--through a performance contract. As a result, it can be argued that the principal incentives affecting the economic performance of public enterprises remain much the same as before. That public managers lack the formal status of a residual claimant does not imply that they refrain from profit-seeking in a personal sense. Because they cannot claim a residual, however, profit-taking requires that operating costs be inflated in order to pay for in-kind benefits. In a society that still operates to a considerable extent through patron-client relationships, managers secure rewards by increasing the payroll. Indirect subsidies are an attractive source of revenues--adding to the profitability of the enterprise from the perspective of its managers. The fact that some cost reduction occurs during a period of reform need not indicate that the long-term dynamic has been altered.

Public enterprise reform is the reverse of the PSIE fertilizer reform case, although the result was much the same. PSIE attempted to privatize at the level of the fertilizer market without modifying the institutional infrastructure, which was dominated by a large public enterprise. Public enterprise reform tries to modify the institutional infrastructure without changing the rules of the marketplace in which the enterprise operates. Divestiture can be

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<sup>25</sup>PROMT studied the performance contracts negotiated for SOCAPALM (one of two major producers of palm oil); Cameroon Development Corporation (a more diversified enterprise involved in palm oil, rubber, bananas, tea, and pepper); and SODECAO (an input-supplier to smallholder cocoa producers). See Hinman (1994b).

expected to work little better than rehabilitation if the rules of the marketplace remain unchanged, still protecting the enterprise from market competition. Privatization at the enterprise level need not improve market performance, although it changes the nature of profit-taking within the enterprise by creating a legitimate residual claimant. Improvement in market performance requires reform at the market level, as well as, frequently, the enterprise level.

Returning to the example of PRAMS I, one can try to imagine the reform of the cooperative structure in NW Province in the absence of market-level reforms--in particular, the cessation of both monopsony privileges and governmental determination of producer prices. Institutional reform of the cooperative structure would have been infeasible as long as these two pillars of the old regime remained in place. Monopsony makes the cooperative the sole legal buyer of coffee; it traps farmers within the cooperative structure, weakening the leverage of farmers within their own organization. Still worse, government-fixed producer prices weakens the incentive of farmers to take the time and exert the effort needed to hold their cooperative officials accountable for their performance. Why bother?--when producer prices are independent of the operating efficiency of the farmers' own cooperative organization.

Market-level reforms and enterprise-level reforms are complementary institutional changes that depend on careful institutional analysis and design. Reform at the market level must at least be cognizant of the existing institutional infrastructure. The wrong infrastructure can frustrate market reform from reaching its objective. Modifying the infrastructure or building new infrastructure raises issues of institutional design. Reform at the enterprise level must at least consider the incentives being supplied at the market level. As long as market rules remain unchanged, there may be little point in proceeding with costly efforts to rehabilitate public enterprises.

### **C. Crosscutting Reforms<sup>26</sup> and the Problem of Governance**

In addition to reform within commodity subsectors, economic liberalization depends on reforms that cut across subsectors and sectors, affecting economic transactions much more broadly. Consider, for example, cooperative law reform in Cameroon, which affected the formation and governance of all sorts of cooperative organizations. While much broader than the market reforms contained in PRAMS I, the new cooperative law was a necessary ingredient in restructuring the arabica subsector, that is, reforming the institutional infrastructure. Without key changes in cooperative legislation, marketing cooperatives would have been unable to adapt to their new market environment.

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<sup>26</sup>The investigation of crosscutting constraints and policy reform was conducted for PROMT by the Private Sector Research Institution (PRISERI) of Cameroon. See Associates in Rural Development and the Private Sector Research Institution (1994).

The illustration can be generalized. Without changes in the general rules of law governing business formation, labor, investments, and contracts, economic actors within reformed sectors are limited in their ability to respond positively to market-level reforms. Such reforms crosscut the economy by affecting a different aspect of nearly every economic transaction, each reform much broader in its impact than any single market-level reform. Crosscutting reforms are macro-level changes that affect virtually the entire economy, while providing the means for economic actors to reshape the institutional infrastructure within commodity subsectors.

In addition to the decontrol of producer prices for export commodities like coffee and cocoa, the structural adjustment program in Cameroon has led to market-level reforms lifting quantitative restrictions on imports and exports and decontrolling consumer prices for a wide range of commodities (Ngwasiri et al 1994). Price-control mechanisms, however, remain in place to administer the exceptions made for reasons of food security or infant industry. The impact of the new market-level freedom depends on building appropriate institutional infrastructure and liberalizing the rules that govern economic transactions more generally. Moreover, in addition to deregulation, changes are needed in the manner of implementation for regulations, such as the enforcement of standard import and export procedures, that remain. Reforms directed at specific markets often depend on complementary crosscutting reforms that permit economic actors to take full advantage of market liberalization with regard to pricing.

### *1. A Range of Crosscutting Reforms*

With the support and encouragement of the World Bank, Cameroon enacted new laws on commercial activity, labor, and investment in 1990. The passage of a law in Cameroon does not, however, complete the process of prescribing new rules. Legislation must be followed by decrees of application, issued by the implementing ministry, before new rules are complete and ready to be applied and enforced. The investment law was followed by a decree of application in May 1991. The Commercial Activity Law was followed by a decree in March 1991; however, it failed to address itself to numerous issues, and the law was not fully implemented until another decree was issued more than two and one-half years later, in November 1993. As of early 1994, no decree had been issued to implement the labor law (Hinman 1994b).

The new laws and accompanying decrees of application prescribe new operational rules to govern economic transactions. In institutional terms, an operational rule sorts actions into those that *must*, *must-not*, or *may* be taken by economic actors in various situations. Actions that *must* or *must-not* be taken imply legal duties and encompass economic restrictions, while actions that *may* be taken define the domain of economic liberty. Cameroon's original investment code, adopted in 1960 and amended in 1984, was heavy with musts and must-nots. Among its most salient features was a requirement that 65 percent of the share capital in a small or medium size enterprise be held by Cameroonians. The 1990 law reduced the requirement to 35 percent. The new labor law increases the flexibility

available in contracting for labor and trades the rigidities of the old system based on territorial wage zones and classified occupations for one based on negotiation between employer and employee. The new commercial activity law relaxes the rules governing business formation. All of these changes, among others, are presumed to enlarge the domain of economic liberty while reducing the severity of legal restrictions.

It is not clear, however, that prescriptive rule changes necessarily alter rules-in-use (E. Ostrom 1992). Cameroon experienced a flurry of formal legislative activity in 1990 when, in the busiest parliamentary session since 1960, the General Assembly enacted some 22 laws to liberalize various sectors of the economy (Ngwasiri et al 1994: 19). To be sure, many of these enactments have actually modified rules-in-use and liberalized economic activity. Some commodity prices once regulated no longer are, for example. However, other changes seek to relax but not erase a restriction. If the degree of relaxation is quantitative and thus measurable, the change is more likely to be fairly straightforward. But if a change leaves substantial administrative discretion to decide when "relaxed" standards have been met, the behavioral effect of the prescriptive change is much less predictable. This seems to be the case with import and export procedures. When the application of a prescriptive rule change depends heavily on the use of official discretion, legislated changes may turn out to be a poor guide to actual behavior under the law.

One of the broadest indicators of how prescriptive market rules affect economic behavior is the size of the so-called informal sector--those economic actors who choose to operate outside the law, foregoing its potential advantages in order to avoid its costs. Much of the cost of operating formally is thought to be the uncertainties and side-payments that accompany required interactions with government officials. These are transaction costs, to be distinguished from the costs of performing legal duties. Legislated reforms that reduce the number and scope of legal duties may not succeed in reducing the costs of transacting business with officials. The informal sector in Cameroon, reported at some 44 percent of GDP, is said to be increasing, not decreasing, as economic liberalization proceeds (Tafah and Fombad 1994: 11). The implication is that the formal sector, governed by the laws of the land, remains too uncertain and too costly for economic actors to risk.

## **2. *The Problem of Governance***

Rule change is an extended process that encompasses four steps: (1) prescription, (2) invocation, (3) application, and (4) enforcement. Together, these four steps comprise the core of the process called "governance." In Cameroon, prescription itself is a two-step procedure: legislation followed by a decree of application. It is the decree that actually guides the process of applying the law in individual cases. Before a rule can be applied, however, it must be invoked. This is the process for raising a claim under a rule-as-prescribed. Sometimes citizens invoke rules; sometimes officials. Application may also be a multi-stage affair if one must first obtain an administrative determination before seeking judicial recourse. Finally, rules-as-applied must be enforced, drawing on sanctions or the threat of sanction to

bring individuals into compliance. There is always some disparity between rules-as-prescribed and rules-as-applied and enforced. Prescriptive rules are general prescriptions intended to be applied in somewhat different cases, similar but not identical. However, too much disparity between prescription and application threatens the integrity of the legislative process, hindering communities from effectively making and using rules to govern themselves. The efficacy of law-making itself depends on the effectiveness of a complex process of governance that extends from prescription through enforcement.

The institutional analysis of rule change requires two levels of analysis: (1) an operational level and (2) a governance level. The operational level of analysis is concerned with how rules-in-use (i.e., rules as applied and enforced) affect patterns of individual choice and behavior. The governance level is concerned with how a deeper set of rules affects patterns of prescription, invocation, application, and enforcement. The process of governance at this level produces the rules-in-use that order behavior at the operational level. The purpose for undertaking rule change is to alter operational behavior, for example, modifying patterns of market exchange. This requires attention to the operational level of analysis in order to figure out what rule changes are likely to engender the intended patterns of behavior. But rules-in-use depend on patterns of governance, which extend beyond making prescriptions. This requires attention to a deeper level of analysis. At this level several questions arise:

- Are proposed prescriptions compatible with the governance rules and procedures in place? The first cooperative law, drafted with the strong participation of donors, was not consistent with the prevailing rules of prescription (rules for making rules) in Cameroon (see discussion above).
- How much official discretion do proposed prescriptions necessarily depend on to invoke and apply the new rules? Given existing governance patterns (including patterns of accountability), how likely is it that a new rule-as-prescribed will actually be applied and enforced? What are the costs of enforcement and how much will these impede the translation of the prescriptive rule into a rule-in-use?
- Finally, does policy reform, referring to changes in rules at the operational level, depend on governance reform, that is, on changes in the rules that supply incentives to officials?

The answer to the last question appears to be "yes." The experience of the World Bank with crosscutting reforms in Cameroon and throughout sub-Saharan Africa suggests strongly that *governance reform*, calculated in particular to strengthen a rule of law, *may be necessary to sustain policy reform*, especially when it relies heavily on the continuing discretion of numerous officials.

The problem with crosscutting rules in Cameroon lies both with their content--too many musts and must-nots--and with the processes of rule prescription, invocation, application, and enforcement that underlie them. Content changes need not alter the institutional uncertainty that affects the process of applying rules in individual cases. One approach to the latter part of the problem is to aim for as much liberality in the law as possible. Reducing the number and scope of musts and must-nots to the bare minimum affords fewer opportunities for officials to invoke rules and apply restrictions. This was clearly the dominant donor strategy in the reform of the national cooperative law. Another approach is to pursue an avenue of reform less closely tied to the official use of discretion. This strategy was behind the strong preference of USAID/Cameroon for private-sector over public-sector reform. Private-sector reform in USAID's policy reform portfolio was focused on moving the provision of private goods out of the public sector, as fully and completely as possible. The FSSRP aimed at full and complete privatization of fertilizer procurement and distribution. PRAMS I, unlike French-sponsored efforts in robusta coffee and cocoa, sought the full liberalization of arabica marketing, internally and externally. USAID did not choose to become involved in public enterprise reform. This strategy was based on an explicit recognition of the difficulties associated with public-sector reforms that presume changes in the official use of discretion.

The third option is governance reform. In the end, all markets depend on some significant degree of official discretion. At one level markets are made by the economic actors who enter into patterns of exchange with one another. At a deeper level markets are made by officials who prescribe, apply, and enforce the rules of exchange. A liberal market economy cannot coexist with an illiberal process of governance--at least with respect to the rules of the marketplace. Both the World Bank and AID have begun to recognize this relationship and are seeking to develop programs to encourage "good governance" (World Bank 1994) and democratization. What this option presupposes is the feasibility of a reform at a deeper level, one that can modify the rules that apply to the conduct of government officials. This entails a process of reform that is considerably less well understood and more overtly political than policy reform, as well as less predictable than economic liberalization.

Policy reform and governance reform, like the enterprise- level and market-level reforms discussed above, should be viewed as complements, not substitutes. Some of the frustration of policy reform is undoubtedly due to inadequacies of governance. If these can be addressed, policy reform becomes less problematic and more productive. Reform at a governance level, however, does not automatically resolve institutional problems at an operational level, that is, getting the rules of governance right does not inexorably lead to getting the market rules right. Moreover, as the experience of Cameroon amply demonstrates, some meaningful policy reform initiatives can be carried out under far less than perfect governance arrangements. How to conduct policy reform under these circumstances is one of the major questions facing donors today.

#### **D. Policy Reform as a Mediated Process: The Role of Donors<sup>27</sup>**

If African societies were well governed, donors could adopt a much less active role in the process of policy reform. It is the weakness of governance that often renders sub-Saharan governments incapable of making credible internal commitments to reform. Citizens do not have sufficient confidence that what their government says today it will do tomorrow. In this situation donors contribute not only financial resources and technical assistance but also the opportunity for the host government to bind itself--to make a commitment that it must keep or undergo a penalty. The inability to make binding commitments is a major institutional weakness of all authoritarian governments. Sub-Saharan societies engaged in a transition to democracy will continue to suffer from this incapacity until they establish a proven record of keeping their domestic commitments. An effective, binding commitment is an enforceable commitment. Because policy reform is a collective good, exposed to the hazards of shirking, the process of reform has to be closely monitored if the commitment to reform is to be kept.

The role of the donor thus includes (1) obtaining a commitment from the host government, (2) monitoring the process of reform so that officials with discretion do not betray the commitment made by their government, (3) "blowing the whistle" when a commitment is violated, and (4) withdrawing assistance if the government fails to correct its course of decision-making. The integrity and effectiveness of donor-assisted policy reform depends on the donor's actively pursuing this role. The World Bank's use of conditionality in the structural adjustment process is consistent with this proposition, but conditionality alone is not always enough. In particular, the process of reform has to be understood as an extended process during which time conditionalities once met are still easily reversed or diluted. The full path of reform has to be monitored. Monitoring must include not only pre-established decision-points to which the government has made an explicit commitment but also unprogrammed or unanticipated decision-points at which the path of reform can take a sudden and expected detour. This means that monitoring must be continuous, not sporadic or periodic only. Such a process is highly labor intensive. It requires of donors a field presence that exceeds the normal contingent of World Bank staffers posted in-country.

Alternative donor approaches to policy reform can be viewed as "catalytic" or "mediating" (see Oakerson and Walker forthcoming). A catalytic approach implicitly views the path of reform as quite simple and straightforward. The principal role of the donor lies at the beginning of the path--to get reform started. Conditionalities apply early on in the process, for example, passing a law or issuing a decree. Once the early conditions are fulfilled, the reform process is expected to unfold in a predictable manner, as if the specified conditions had fully determined the path to be taken. The alternative approach views reform as an extended process that requires mediation along the entire path of reform. The donor becomes more than a catalyst. Reform depends not only on policy actions occurring at points that can be specified in advance but also on policy restraint (non-action) that is continuous.

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<sup>27</sup>This subsection draws on Oakerson and Walker (forthcoming).



Maintaining the necessary collective restraint when numerous policy actors face strong temptations to shirk depends on various types of mediation.

The process of obtaining a commitment to reform is mediated by processes of inquiry and deliberation. This begins with a focus on relatively discrete problems--such as the fertilizer distribution system is not working, the costs of processing and exporting coffee are too high, or cooperatives resent what they view as excessive government interference. Dealing with specific problems helps to discipline the process of reform, including the participation of donors. Problem-solving, rather than installing one's own worldview, becomes the common focus of attention. Problems do not come equipped with ready-made solutions, however. Reform develops in response to a diagnostic assessment of problems, which can be analytically demanding as well as time consuming. Institutional analysis is a means of diagnosing problematic situations that leads to prescriptions for reform--changes in the relevant rules expected to modify existing incentives, alter patterns of interaction, and produce different outcomes. Both the FSSRP and PRAMS I were preceded by extensive fact-finding, institutional analysis, and consultation with both private and public actors. If reform is to be a common undertaking, it has to proceed as much as possible on the basis of a common understanding of the means and ends of reform. The policy dialogue that precedes a formal agreement between a donor and the host-government can be viewed as an opportunity for both parties to learn and adjust their conceptions of the problem at hand. This applies to discussions with private parties, such as the NWCA in PRAMS I's cooperative restructuring component, as well as to government representatives.

The core of any reform effort is a change of rules. This requires that reform be mediated by information and opportunities for learning new strategies. In the FSSRP, for example, the bible of the program was a *General Information Pamphlet* that contained all the relevant rules. The pamphlet became the definitive frame of reference for all participants, whether seeking to invoke an existing rule or argue for an exception or a new rule. In PRAMS I, the Memorandum of Understanding (MOU) signed between NWCA and USAID served a similar purpose, though not as effectively. The MOU's weakness in this respect lay in its not delineating the relationships among the three tiers of the cooperative structure as clearly and concisely as it might have. In retrospect, another document, one more purely informational in nature, would have been useful. Clearly understanding the new rules provides a basis for conceptualizing new strategies on the part of participants. Policy reform often necessitates not only that individuals choose different strategies but also that they choose unfamiliar strategies. This requires a period of testing and learning. Relatively standard forms of training and technical assistance can be helpful in this process, but so can more informal arenas of learning. During the FSSRP, USAID staff members simply made themselves available to prospective fertilizer importers for discussion. This proved to be useful in facilitating market entry by persons accustomed to playing a much different game in dealing with government bureaucrats.

Inquiry and diagnostic assessment need to continue throughout a transition period in order to take account of a dynamic economic environment and monitor the effect of rule changes on economic choice and behavior. Reforms need to be viewed as hypotheses--propositions that state an anticipated relationship between rules, on the one hand, and individual strategies and actions, on the other hand. Even while grounded in theory and research, whether the proposition holds under particular time-and-place conditions is conjectural, subject to the test of experience. Seldom can a complex reform agenda get it completely right the first time. Reform therefore should be viewed as an iterative process--changing rules, observing the results, and correcting errors by again modifying the rules. Both the FSSRP and PRAMS I anticipated the iterative nature of reform by including an annual review and assessment process (three times a year in the case of the cooperative restructuring component). In both cases the process was instrumental in modifying the package of reforms in view of experience.

Once the process of reform is underway, other types of mediation also become important. The process of reform can be conflict-laden as economic and political actors test the limits found in new rules and try out strategies. Conflict is costly to all participants, and donors may be tempted to suppress conflict when it arises. However, it is important to view conflict as indicative of unresolved problems and use it as an occasion for renewed inquiry, analysis, and discussion. If conflict is not dealt with productively, it can unravel the threads of common understanding that undergird reform. Signing a formal agreement does not finish the process of maintaining working agreement among the parties, which can fall apart at various points along the path of reform. Mediation that begins with the effort to secure a commitment must continue as conflict threatens to undo what was earlier agreed to.

The collective-good nature of reform implies that in the long run virtually everyone in a society is expected to benefit, although the short run requires sacrifice from many. The forces favorable to reform derive from the potential for long-term gain; the forces opposed, from short-term loss. Through mediation, donors make common cause with the economic and political forces friendly to reform, seeking to overcome short-term pressures to shirk. There is also a medium-term period of reform when new rules have become established so that some economic actors can take advantage of them, but others, those who were previously advantaged by the old rules of the game, are left worse off. The medium term, because it is dominated by winners and losers, is an especially fragile stage of reform. During this period reform should be mediated by processes that create and mobilize political support from stakeholders in the new regime. Donors can play a useful role in this process as well, while stopping well short of political interference. USAID's support for the development of a market information system in the later stages of PRAMS I created an important new stakeholder in the reformed arabica subsector and assured the new system of high public visibility.

Donors can play a productive role in policy reform in many ways. Yet, the role is circumscribed in important ways as well. Although donors can vigilantly monitor the process of reform and forcefully raise objections, all the while providing assistance that mediates reform along numerous dimensions, in the end donors are highly constrained in what they can do to enforce the provisions of a policy-reform agreement. As international actors, donors are limited largely to suspension or cancellation of assistance, blunt instruments that, as Don Hinman notes (1994a), donors and lenders are reluctant to use. Just as reform is a collective good, donors are limited to collective sanctions, deployed against governments. Unlike the classic monitor in a process of collective action, donors usually cannot sanction individuals (although the relationship between USAID and NWCA in PRAMS I is an instance where sanctions were not limited to the government even though the government was the official recipient of the program assistance). In particular, donors cannot sanction government officials or, more to the point, intervene selectively to obtain their compliance. Only host-governments have this capability. Donors therefore must work closely with representatives of the government throughout the process of reform, not just at the beginning. For this reason, both PRAMS I and FSSRP established coordinating committees composed of both donor and government representatives. These groups became important institutions of mediation, providing a link between the monitoring role of the donor and the selective enforcement capabilities of the host-government, in fact involving government representatives directly in the joint monitoring of reform.

## V. CONCLUSION: MAKING REFORM WORK

The policy changes that typically make up a structural adjustment program are institutionally diverse. The changes may include currency devaluation, government spending reductions, adjusting commodity prices to better reflect world markets, deregulation of commodity prices, termination of monopoly and monopsony arrangements, regulatory restraint in relation to imports and exports, and the revision of economic legislation with effects that crosscut the economy. All of this usually falls under the banner of "policy reform." Yet, in institutional terms, a currency devaluation is an *operational action* taken by the government as an economic actor. So is an adjustment of commodity prices. Deregulation of prices is a change in the *operational rules* governing economic actors in the marketplace, an adjustment not of prices but of economic duties and liberties. A change in operational rules requires *governance actions* to prescribe, invoke, apply, and enforce a new rule. If a new rule-prescription depends on substantial discretion on the part of officials to invoke and apply the rule, the process may be subject to considerable uncertainty. In any case, operational actions are much more easily prescribed and implemented than rule changes because governance is much more complex. If the governance process is considered to be institutionally weak, it may be necessary to change the *governance rules* that assign and distribute the authority to prescribe, invoke, apply, and enforce operational rules. This moves beyond policy reform and into governance reform. Changes in governance rules require *constitutional actions*, which are even more problematic than changes in operational rules.

Sorting policy changes into three levels of action--operational, governance, and constitutional--highlights the differences among them. The choice of donor approach in support of policy change needs to take these differences into account. On the one hand, a catalytic conception of policy change may be appropriate if the change occurs entirely at the operational level within a given set of rules. The path of change is then relatively short and predictable; the transition, almost immediate--as in devaluation--once the commitment is obtained. The focus of the relationship between donor and host-government is on obtaining a single, unambiguous action. The decision may be difficult, but once taken, the action is often not easily reversed, at least not in the short term. In this instance conditionality is a straightforward matter: implementation is easily monitored, and the commitment is easily enforced. On the other hand, a change in the rules of the marketplace may respond poorly to a catalytic approach. Satisfying an initial condition, such as passing legislation, does not assure that any significant change will occur in the rules-in-use at the operational level. Scores of opportunities may still exist to deflect the change, as new rules are invoked, applied, and enforced. Predictability is replaced by uncertainty and the constant threat of reversal through a transitional period.

Institutionalism suggests some slight modifications of language in this area. Because the term "policy reform" is presently used to cover a multitude of changes, it fails to make important distinctions. From an institutionalist perspective, reform refers to a change of rules. Policy reform would then be used to designate a change of operational rules, to be distinguished from a policy change that requires only a different operational action within

existing rules. Policy reform can also be distinguished from "governance reform," which refers to changes in the rules for prescribing, invoking, applying, and enforcing operational rules. Different still, and much deeper in the structure of the polity, lies "constitutional reform."

Mediation is appropriate to all processes of reform. In a well-governed society, policy reform can be mediated through existing governance structures. If constitution-making is adequately distinguished and separated from ordinary law-making, it is also possible to draw on existing constitutional structures to engage in governance reform. Neither of these preconditions holds throughout most of sub-Saharan Africa. The "reformability" of such societies is highly problematic. The basic question is whether donors can supply some of the "good offices" of mediation that host-countries are unable at present to provide for themselves. The experience of Cameroon suggests, tentatively, that the answer is a qualified "yes." The qualifications, while numerous and demanding, can be collapsed as follows.

*First*, mediation depends on methods of analysis that are not widely practiced in the development field. The present era of policy reform, not to mention the possible coming era of governance reform, requires a different set of analytical skills than those that served well during the "project" era when capital investment and technology transfer was the focus of development work. The shift to reform has not been accompanied by appropriate changes in the available complement of analytical skills and methods, at least not at the scale required for undertaking change of continental proportions. When development is viewed as an operational-level problem, institutional analysis has less to offer. When it becomes a governance-level problem, as it does when operational rules must be changed, institutional analysis becomes the methodology of choice.

*Second*, mediation depends on the willingness of development agencies and their officers to travel a long-term, uncertain, shifting path of reform. Mediation requires a long-term and intensive engagement in the process of reform. It is not at all clear that the major donors and lenders, including AID, are ready for this level of engagement. Administrators in general prefer the straightforward to the complex, the predictable to the unpredictable, the conflict-free to the conflict-laden. When serious conflict develops mid-way into a policy-reform program, many donor-agency administrators may panic. This is because they tend to view conflict as something that is not supposed to happen. The mediated conception of reform anticipates quite the opposite. Conflict is expected to occur, and donors have to be ready to deal with it productively and creatively, not simply try to suppress it in the time-honored bureaucratic mode of "putting out fires." This requires not only a labor-intensive commitment of resources but also an acceptance of conflict and uncertainty that runs counter to the standard bureaucratic mentality.

AID, with its more highly decentralized mode of field operation, may be better situated to pursue a mediated approach than other development agencies that are more centralized in terms of both policy initiatives and staffing. It was this decentralized structure that allowed USAID/Cameroon to engage in an institutionalist experiment while conforming

to broad AID/Washington guidelines and expectations. Yet, a process whereby each mission simply goes its own way is not likely to yield a consistent approach to policy reform. Some combination of field discretion with strong regional-bureau and central-bureau support for appropriate concepts and methods of analysis would be the most conducive to the diffusion of the mediated approach. The development and dissemination of concepts and methods appropriate to reform is the crucial element.

Economic policy reform does not fail because it is ill advised or unneeded, but because the process of reform is difficult and not well understood. Moreover, the analytical technique needed to conduct policy reform is in short supply. Yet, policy reform can be a productive and energizing endeavor for all parties involved--this much Cameroon has shown. Furthermore, the use of institutional analysis can make the conduct of policy reform a cumulative, knowledge-building activity. As applied institutional analysis becomes a recognized professional practice, it can increasingly supply much of the analytic capability and know-how needed to make reform work.

## APPENDIX

### A FRAMEWORK FOR INSTITUTIONAL ANALYSIS

Underlying this report and the effort to "get the rules right" in Cameroon is an important thesis--that the conduct of policy reform is best served by institutional analysis. This appendix first sketches the argument linking policy reform to institutionalism, then summarizes the conceptual underpinnings of institutional analysis and design.

#### A. From Policy Reform to Institutional Analysis

##### 1. *Reform Depends on Changing the Rules*

Institutional analysis is something more than "policy analysis," as this term is conventionally used. Policies are often viewed as instructions to decision-makers (see Nakamura and Smallwood 1980: 31). A new policy is a new set of instructions. Sometimes instructions are written as rules, in which case the relevant rule is of a particular type--a mandate to act in the prescribed fashion. Institutionalists are not particularly interested in policies as instructions. They are instead interested in rules that assign and distribute (and thereby limit) discretion. Discretion is the ability to choose among a range of alternatives. Rules specify who has how much discretion over what. In a phrase, the rules tell us "who decides what in relation to whom." This is the substance of policy as reform--not writing a new set of instructions on how to use one's discretion, but reassigning and redistributing discretion in such a way that individual decision-makers arrive at choices that conform more closely to preferred patterns. Getting the rules right becomes the major preoccupation of institutionalists.

##### 2. *Rules Need to Be Adapted to the Nature of the Physical World*

Rules do not operate in a world by themselves. They operate only in a world also populated by physical constraints and opportunities. This is a point often overlooked when examining political institutions. Instead, it may be assumed that governments and their agencies function irrespective of the physical context in which they must operate. Although governments may perhaps be designed in rather abstract terms, the difficulties come in when governments have to be fitted to specific types of problems--water problems or highway problems, irrigation problems or transportation problems. Fitting governments to problems, or (more broadly) fitting institutions to problems, where problems are defined partly in physical and/or technical terms--this is the institutionalist's distinguishing perspective on issues of public policy. Each type of problem, it is argued, requires a somewhat different fit. The appropriate institutional arrangements therefore vary from one physical context to another (V. Ostrom 1989: 46-48). In the design of a market economy, it is the variety of goods and services--all of which may be appropriate for market exchange at some point--that leads to

diverse institutional arrangements, each a different variation on, and modification of, the free-market theme.

### **3. *Rules Work in Configurations Called Institutions***

Neither do rules operate in isolation from one another. Instead, closely related rules work together to construct a rule configuration called an institution (E. Ostrom 1986). Often, this leads analysts to sort rule configurations into broad types or standard forms. This enables us to distinguish institutions that are sharply different from one another, for example, markets and states (Lindblom 1977). At the same time, however, it is useful to recognize that governmental arrangements can be designed with significant quasi-market features (V. Ostrom 1991) and that markets can make significant use of the collective-choice arrangements typical of government (Bates 1989). Reform is not just about assigning or reassigning responsibilities among standard-form institutions; it is more about redesigning or reconfiguring institutional arrangements to fit the problem at hand. This approach to institutional craftsmanship often mixes the features of standard-form institutions in ways that defy classification according to traditional categories.

### **4. *Rules Work by Creating Incentives***

Rules are often identified solely with mandates and restrictions--what individuals must or must not do. In this sense, rules substitute for discretion (Wilson 1989: 334-336). However, rules also assign permissions--what individuals may do. A rule configuration is a systemic arrangement that distributes different but related permissions across individuals in different positions. Discretion--the freedom to choose among alternatives--is being created and parceled out even as it is being limited. The basic point of institutional design is to distribute discretion so that individuals have incentives to act in a preferred manner.

Incentives are created by linking outcomes to the way in which discretion is used. In other words, if your discretion can affect outcomes important to me, and if my choice can affect the way you use your discretion, then my use of discretion is constrained. If you have no discretion that affects outcomes important to me, I can act with impunity. The perceived link between your choice and my outcome creates my incentive to act in ways that you prefer. In such a manner, institutional arrangements can be designed to create incentives for individuals to act in mutually beneficial ways. Institutional weakness or failure occurs when the incentives lead individuals to use discretion in ways that leave one another worse off.

### **5. *Rules Have to Be Prescribed, Invoked, Applied, and Enforced***

Institutions are neither self-creating nor self-maintaining (V. Ostrom 1989: 55). A rule is a prescription. There is no prescription without a process of prescribing. Rules do not arise spontaneously from the patterns of interaction that they govern. Just as there is no bread without baking, there are no rules without prescriptive work. Moreover, because rules always imply limits on discretion, these limits have to be invoked, applied, and enforced.



Individuals cannot be expected to observe limits on an entirely voluntary basis. To the contrary, individuals can often be expected to test limits.

Rule prescription is fairly well understood; it is what legislatures, among others, are supposed to do. What happens after prescription is often lumped together as "enforcement." This is unfortunate, because enforcement is often then identified solely with the power to impose sanctions. This, however, is only part of what has to happen after prescription. First, someone has to "invoke" the rule, that is, lay claim to the limit that the rule specifies. Legal codes and statutes are filled with rules that no one invokes and are therefore dead letters. Second, someone has to decide whether or to what extent the rule "applies" in the specific case. Rules are written in general language so that they can apply in many cases; but this creates the necessity (and the need for discretion) to decide when a rule applies and when it does not apply. Finally, someone has to impose and execute a judgment and possibly a penalty if the prescribed limit has not been observed: this is enforcement.

None of the above is automatic; all is problematic. "Getting the rules right" means knowing the right rules to prescribe, but it also means more. It means allowing individuals with an incentive to invoke the rules to do so; it means applying the rules appropriately in relevant circumstances; and it means enforcing the rules fairly and equitably. Frequently, there is a significant disparity between rules as prescribed and rules as applied and enforced. The rules that are consistently applied and enforced in a given situation can be considered the relevant "rules in use" (E. Ostrom 1992: 19) even if inconsistent with the rules as prescribed.

## **6. *Reform Draws upon Multiple Levels of Analysis***

Institutional analysis begins by examining an operational situation, one in which individuals take action that directly affects the physical world and generates welfare outcomes. At this level the design question is this--what set of rules will enable individuals to interact in mutually beneficial ways? The actual rules in use at the operational level, however, depend on patterns of interaction at a deeper level. These are the interactions by which operational rules are prescribed, invoked, applied, and enforced. These interactions are also ordered according to a set of rules. "Governance rules" can be defined as those that assign and distribute the discretion to prescribe, invoke, apply, and enforce operational rules. Governance rules also have to be prescribed, invoked, applied, and enforced. "Constitutional rules" can be defined as those that assign and distribute the discretion to prescribe, invoke, apply, and enforce governance rules.

Reform therefore draws upon multiple levels of analysis (see Kiser and Ostrom 1982). At one level we ask how different rules will affect patterns of interaction in some operational situation. To ask how a given set of rules can be prescribed, invoked, applied, and enforced takes us to a deeper level. These activities are also rule-based, that is, they depend on the limited use of discretion, which is assigned and distributed by a set of rules. Like operational rules, governance-rules work by assigning and distributing discretion, creating incentives by linking choices with outcomes. If governance-rules fail to work as intended, reform may

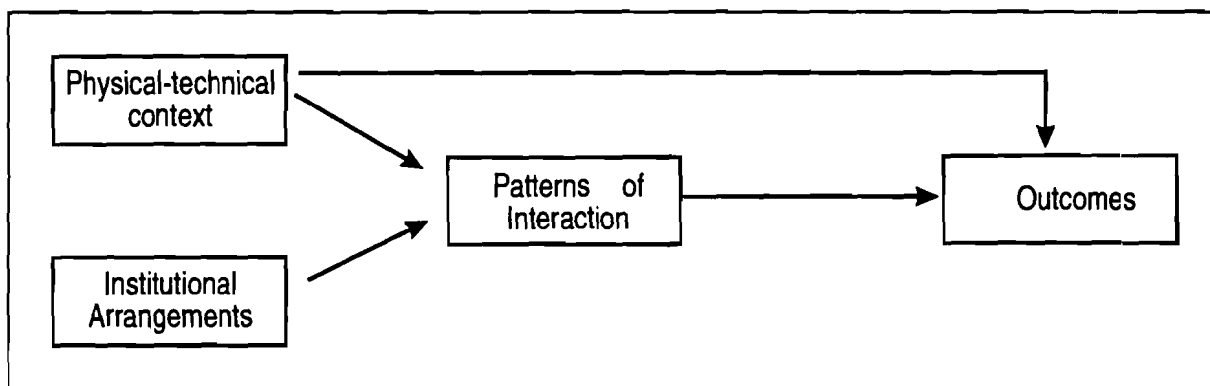
needed at this level. This depends on still a deeper set of rules, which are those we call constitutional. In some cases, reform too must go this deep.

## B. A Framework for Institutional Analysis

The argument sketched above implies a particular conceptual framework for institutional analysis. The framework, in its most economical expression, consists of four concepts and their relationships (V. Ostrom, 1989; Oakerson 1992),<sup>28</sup> applied at three levels of analysis: operational, governance, and constitutional.

The basics of institutional analysis can be understood in terms of the relationships among four elemental sets of variables:

- (a) the physical-technical structure of the world we live in;
- (b) institutional arrangements, composed of rules;
- (c) patterns of interaction or decision-making among individuals; and
- (d) outcomes that matter.



**Figure A-1. Basic Framework for Institutional Analysis**

Figure A-1 displays the basic framework in schematic form. Both the *physical-technical structure of the world* and *institutional arrangements* directly affect patterns of interaction. Both the structure of the world and the structure of institutions supply opportunities and constraints--opportunities, which individuals can pursue, and constraints, which individuals must observe if they are to achieve intended outcomes. From *patterns of*

<sup>28</sup>For a more elaborate version of the framework see Kiser and Ostrom (1982).

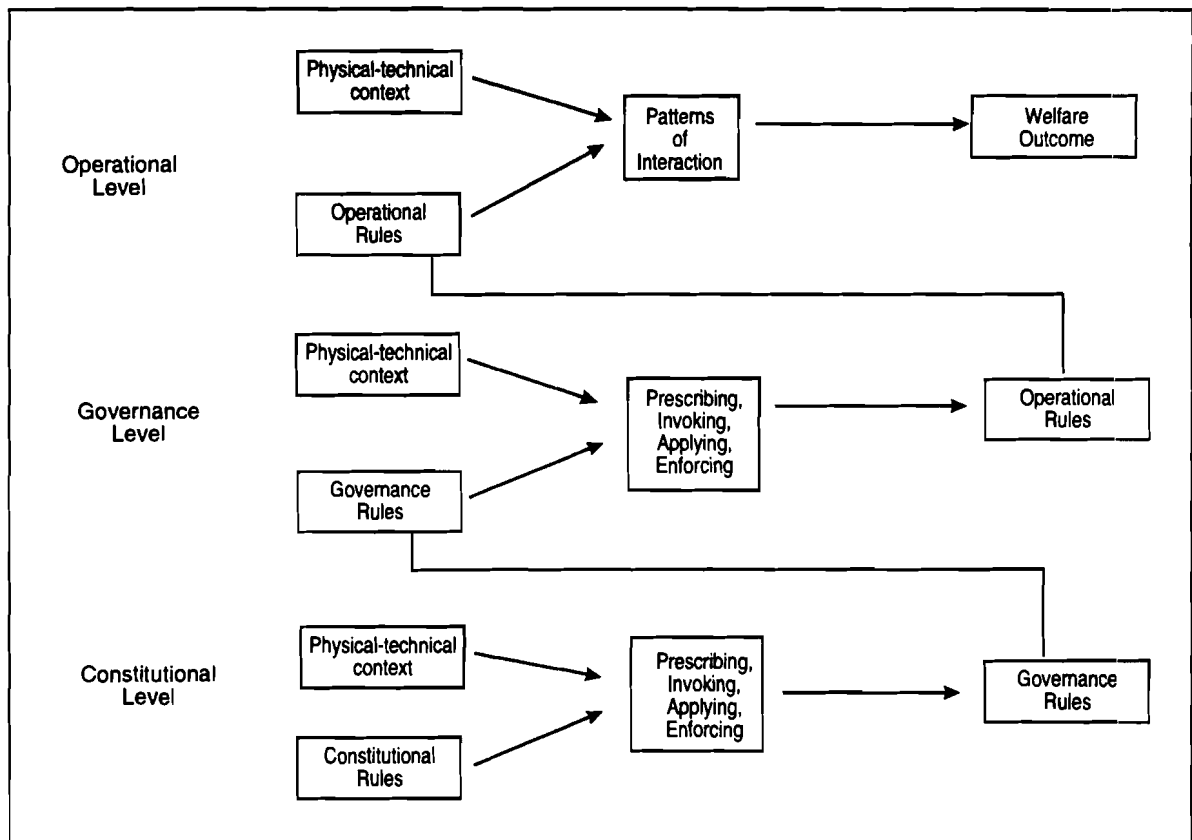
*interaction* among individuals follow *outcomes*, intended and unintended, which consist of changes in the welfare of individuals and communities as measured or assessed according to various scales of value.

Note that the physical structure of the world also directly affects outcomes. By definition, outcomes are based on an evaluation of the state of the world. In addition, the structure of the world imposes "hard constraints" on human beings who interact. The laws of nature are not subject to repeal and can never be ignored with impunity. No matter what human beings do, the structure of the world we live in will affect outcomes. By contrast, institutional arrangements affect outcomes only *through* patterns of interaction. Institutional arrangements impose only "soft constraints" on human beings. The effect of rules depends on the strategies that individuals choose.

An institutional analysis begins by describing each set of variables in an operational situation. Sorting available data into the four sets can clarify the nature of a problem and reduce the confusion that often accompanies troublesome situations. Once the data are sorted and the attributes or values of the key variables are known, the empirical relationships among the four sets of variables becomes the focus of work, important both in diagnosing the sources of a problem and designing new institutional arrangements.

Diagnostics begin with outcomes and work backward through the framework. Outcomes follow from some pattern of interaction, which follows from a set of institutional arrangements within a particular physical setting. The diagnostic focus is on the incentives supplied by an existing set of institutional arrangements, given the physical-technical context. Perverse incentives are understood to derive from a mismatch between the rules and physical facts of a situation. Design begins with the relationship the physical world and institutions and works forward through the framework. The aim is to create incentives that support patterns of interaction that generate preferred outcomes.

The analysis is carried out somewhat differently at different levels, as shown in Figure A-2. At the operational level, patterns of interaction consist of relevant operational activities. For example, in the marketplace operational activities consist of buying and selling. Market activity takes place, however, subject to a set of rules and within a specifiable physical-technical context. An operational analysis in this case is concerned with how a set of market rules affect patterns of exchange. There is, of course, an enormous variety of operational situations that might be relevant to policy reform. At the governance level, patterns of interaction consist of prescribing, invoking, applying, and enforcing operational rules. What emerges from the governance level as outcomes are simply the rules in use at the operational level. Similarly, at the constitutional level, patterns of interaction consist of prescribing, invoking, applying, and enforcing governance rules, i.e., the rules in use at the governance level. Constitutional rules are the rules in use at the constitutional level.



**Fig. A-2: Three Levels of Institutional Analysis**

Policy reform can be understood as changes in the operational rules governing some situation. These changes require action at the governance level. What is more, the action required is not only prescriptive but also involves invoking, applying, and enforcing operational rules. The process of policy reform is therefore an extended process that entails a recurrent series of decisions over time. Governance reform can be understood as changes in the governance rules, which specify who may prescribe, invoke, apply, and enforce operational rules. Governance reform requires action at the constitutional level.

Institutional analysis therefore depends on two basic types of relationships among variables. One consists of relationships at a single level of analysis, with the critical linkage mediated by institutionally derived incentives. The other consists of relationships between different levels of analysis, one nested in the other. Patterns of interaction at the operational level depend on patterns of interaction at the governance level, which depend on patterns of interaction at the constitutional level. Problems that present themselves as operational problems may depend for their resolution on changes at deeper levels of analysis.

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